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Outlook for the Economy and Real Estate

REALTOR®

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The Outlook For the Economy and Real Estate

The economy grew at a modest rate of 2.4 percent after adjusting for inflation in the third quarter. Most of this growth can be attributed to significant gains in consumption. Developments in the automobile industry played a major role in boosting overall consumption in that period and will also impact the level of production in the fourth quarter. In fact, the third quarter figure would have been stronger had there not been a further deterioration in the trade deficit. While the near-term forecast remains positive with fourth-quarter real growth expected to increase about 3.0 percent, this rebound will be both modest and short-lived. By next year, the combination of tax reform, an aging recovery and fiscal restraint associated with Gramm Rudman Hollings will slow the expansion to under a 2 percent annual rate.

The following are highlights from the third quarter:

	Contribution to GNP Growth (Percentage Points)
o Consumption spending increased at a strong rate of 38 percent from the second quarter buoyed by cut-rate auto financing. However, because the rise in car sales was largely offset by a drop in inventories, it did not lead to an increase in production and, therefore, its impact on real output growth was diluted.	4.7
o Residential Investment, while remaining at healthy levels, has slowed from the brisk pace experienced earlier this year. The largest contributor to the slow down has been the dampening in construction of multi-family units due to removal of many investment incentives in this area.	0.4
o Nonresidential Investment was nearly flat in the third quarter. However, the composition of investment was distorted by tax reform. Investment in equipment increased modestly in the third quarter as many manufacturers are trying to take advantage of the transition rules. Investment in non-residential structures continued to decline in the third quarter reflecting vacancy rates at double digit levels, thereby, subtracting 0.3 percentage points from GNP growth.	0.0
o Inventories fell in the third quarter as auto makers attempted to clear out their lots of 1986 models through cut rate financing incentives. The decline in inventories subtracted over two percentage points from GNP growth.	-2.1
o Net Export growth continued to decline in the third quarter leading to a widening of the trade deficit. The 15 percent real increase in exports was absorbed by a 20 percent increase in imports. As a result, the foreign trade sector subtracted over 1 percentage point from GNP growth in the third quarter. However, recent monthly data suggest that this trend in export growth should soon be reversed.	-1.2

- o Government Purchases increased modestly in the third quarter contributing little to GNP growth. However, government purchases are expected to rebound during the fourth quarter due, in large part, to increases in Commodity Credit Corporation (CCC) purchases. The CCC is a federal program whereby the Federal government purchases crops at support prices. 0.7

The economy has been growing fitfully for the last 2 and 1/2 years and appears likely to continue to do so for the next year. The major stimulus to growth next year will be a long-awaited rebound in net export growth. Recently, the declining value of the dollar has had some limited positive impact on the nation's trade performance as evidenced by two consecutive monthly declines in the trade deficit. However, those sectors that previously provided strength, consumption and housing, will not be be able to sustain the recovery as they have in the past. Increases in personal income are expected to remain sluggish and a growing level of consumer debt will likely dampen overall spending in 1987. Less spending by the consumer, lower levels of investment due to tax reform, and reduced levels of governnent spending will likely hold real growth in 1987 GNP to below 2 percent for the entire year.

The outlook for inflation in both 1986 and 1987 remains very favorable. The inflation rate for all of 1986, as measured by the Consumer Price Index (CPI), will likely be below 2 percent--the lowest level in 20 years. In 1987, the key influences on inflation will be the depreciation of the dollar, the effect of the increased slack in labor and product markets, and some further softenening of oil prices in the first half of the year. While the depreciation of the dollar will boost inflation, moderate wage demands and the weakness in oil prices will tend to soften this effect. As a result, overall inflation is expected to increase at a modest 3.5 percent rate next year.

Interest rates remain quite volatile reflecting investor jitters over the political and economic outlook. The bond market remains somewhat nervous about the current strength in economic activity, possibilities of renewed inflation due to rising oil prices, and the potential effects of a depreciating dollar on foreign investor appetites for U.S. securities. However, it is doubtful that many of these fears will be fully realized over the next year. Any anticipated growth in economic activity will be both modest and temporary. While oil prices are expected to begin to rise by late this year, lower unit labor costs should continue to put downward pressure on overall prices. Finally, the Japanese press report that the Bank of Japan is considering a cut in the discount rate is good news for U.S. interest rates. A reduction in Japan's interest rate could make U.S. securities more attractive to Japanese investors. It would also give the federal reserve greater leeway to ease credit conditions. Therefore, for these reasons, interest rates are expected to slowly trend downward next year. Long-term interest rates are expected to reach 7 percent and short term rates should dip below 5 percent.

Real Estate Markets

Over the past year, the housing market has been one of the few bright spots in an otherwise sluggish economy. The strength in housing can be attributed to an expected annual average mortgage rate of 10.0 percent in 1986 -- the lowest level this decade. This year alone, over 3.4 million existing homes are expected to be sold and over 1.2 million single-family homes are expected to be started, making it the best year for housing since 1979.

Lower interest rates are expected to keep sales of existing homes at healthy levels throughout next year. In 1987, existing homes are expected to continue to be sold at a healthy pace of 3.4 million units. However, slower growth and tax reform will dilute the positive impact of lower mortgage interest rates on new residential construction. Residential investment will follow two distinct paths. Slower growth in the economy will lead to a modest decline in construction of single-family homes with about 6 percent fewer homes expected to be started in 1987. In contrast, construction of multi-family housing will be adversely affected by tax reform and these units are expected to decline by as much as 25 percent in 1987.

Table 1 November 1986

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4,176	4,234	4,286	4,335	4,376	4,424	4,470	4,525	3,765	3,998	4,211	4,401	4,614
% Change	2.6	5.7	5.0	4.6	3.9	4.5	4.2	5.3	10.5	6.2	5.3	4.5	4.8
% Change (w/out inflation)	0.6	2.4	3.1	1.7	1.4	1.5	1.4	2.2	6.4	2.7	2.6	1.9	2.5
Consumption	6.2	7.2	1.2	1.9	1.3	1.0	0.4	1.0	4.7	3.5	4.0	1.8	2.0
Durables	14.3	38.4	17.2	1.4	0.4	0.2	1.0	2.1	12.7	7.8	6.1	1.5	0.3
Nondurables	8.0	0.8	1.8	1.7	1.3	0.9	0.7	1.6	3.6	1.6	4.0	1.7	1.3
Services	2.6	3.5	2.2	2.2	1.8	1.3	0.7	1.6	3.4	3.7	3.5	2.1	1.4
Residential Investment	14.5	7.2	2.9	2.6	5.9	2.8	1.2	0.9	14.3	3.9	8.6	0.9	0.4
Nonresidential Investment	0.9	2.3	1.2	0.2	2.9	1.1	2.0	0.4	16.9	9.3	0.8	0.6	-0.4
Structures	35.2	9.3	1.8	1.9	1.4	0.7	1.0	0.4	11.1	7.7	11.3	3.6	0.2
Equipment	19.6	1.4	2.4	0.5	4.5	1.8	2.5	0.3	20.0	10.1	4.3	0.7	0.6
Exports	9.8	15.4	3.4	6.9	9.8	10.2	9.9	9.2	6.2	2.0	2.0	7.3	8.8
Imports	15.8	20.0	0.0	0.8	2.3	0.3	1.0	0.5	23.2	3.8	10.7	3.0	0.6
Government Purchases	9.7	3.6	14.2	8.5	0.9	3.7	8.7	7.0	4.0	6.8	3.7	2.5	1.4
Contribution to GNP Growth (Percentage Points)													
Consumption	4.0	4.7	-0.8	1.2	0.8	3.6	0.3	0.7	2.4	2.3	2.5	0.7	1.1
Residential Investment	0.7	0.4	0.2	0.1	-0.3	-0.1	0.1	0.0	0.2	0.4	0.4	-0.1	0.1
Nonresidential Investment	0.1	0.0	0.1	0.0	0.4	0.1	0.2	0.0	1.7	0.8	0.5	0.2	0.1
Structures	1.7	0.3	0.1	0.1	0.0	0.0	0.0	0.0	0.5	0.1	0.6	0.0	0.0
Equipment	1.6	0.4	0.2	0.0	0.4	0.2	0.2	0.0	1.2	0.7	0.1	0.2	0.1
Inventory Change	2.7	2.1	0.8	1.9	0.3	0.5	1.3	1.5	0.2	1.1	0.2	0.1	0.0
Net Exports	3.0	1.2	0.3	0.6	1.3	1.0	0.9	0.9	1.4	1.1	0.8	0.9	0.7
Government Purchases	1.9	0.7	2.8	1.8	0.2	0.7	1.7	1.5	1.5	1.6	0.7	0.2	0.3
Mfg. Capacity Utilization	79.5	79.8	79.9	79.3	78.7	78.2	77.7	77.4	80.8	80.3	79.8	78.5	77.1
Domestic Auto Sales	9.1	9.7	7.2	7.0	7.0	6.9	6.7	6.7	8.0	8.2	8.2	6.9	6.8
Personal Income Per Household	41,985	42,118	42,559	42,874	43,187	43,468	43,809	44,195	38,154	40,285	42,028	43,340	44,858
Percent Change — Year Ago	4.7	3.9	4.0	2.1	2.5	2.1	2.2	2.3	8.6	5.6	4.3	3.1	3.5
Personal Taxes Per Household	6,083	6,238	6,327	6,182	6,250	6,316	6,382	6,111	5,393	5,913	6,165	6,284	6,235
Percent Change — Year Ago	8.6	4.5	3.1	1.6	2.0	1.7	3.2	-2.2	6.2	9.6	4.3	1.9	-0.8
Disposable Personal Income Per Household	35,900	35,880	36,233	36,692	36,937	37,152	37,427	38,084	32,761	34,372	35,863	37,056	38,623
Percent Change — Year Ago	3.9	3.0	3.8	2.2	2.9	2.5	2.0	3.1	3.4	4.9	4.3	3.3	4.2
Employment (millions) (civilian household basis)	109.2	110.0	110.3	110.5	110.7	110.8	111.0	111.1	105.0	107.2	109.6	110.8	111.4
%-Change	1.7	2.8	1.1	0.8	0.5	0.7	0.6	0.2	4.1	2.1	2.2	1.1	0.6
Unemployment Rate (%) (civilian household)	7.2	6.9	7.0	7.1	7.3	7.4	7.5	7.7	7.5	7.2	7.0	7.3	7.7
Consumer Prices (CPI)	1.7	2.6	3.7	3.1	3.1	3.3	3.5	3.4	4.3	3.5	2.0	2.9	3.4
GNP Deflator	1.8	3.6	1.7	2.9	2.5	2.9	2.8	3.2	3.9	3.3	2.7	2.6	2.9
Personal Consumption Inflation	1.1	2.9	3.5	3.1	3.1	3.2	3.4	3.3	3.8	3.5	2.0	2.9	3.3
Residential Construction Inflation	5.6	4.0	2.8	2.5	3.3	3.8	2.9	2.7	4.1	1.8	3.6	3.3	3.2
Nonresidential Const. Inflation	-0.4	2.8	1.8	3.3	3.4	2.9	2.9	3.3	-0.2	0.7	1.4	2.7	3.1
Producer Price Inflation	-5.5	0.4	4.2	4.0	4.1	3.9	3.9	4.0	2.1	0.9	-1.4	3.0	3.9
Before Tax Corporate Profit	231.3	245.9	268.1	265.2	262.7	271.3	276.5	282.2	235.7	223.1	242.4	268.9	294.4
Corporate Tax Liability	93.3	99.2	134.6	126.2	127.3	130.9	132.9	123.4	95.4	91.7	104.0	129.3	127.7
After Tax Profits	138.0	146.7	133.5	139.0	135.4	140.4	143.6	158.8	140.3	131.4	138.4	139.6	166.7
Inventory Valuation Adjustment	10.6	7.1	4.5	4.1	4.8	7.0	7.0	-6.2	-5.5	-9.5	7.4	5.7	-8.3
Capital Consumption Allowance	51.3	50.4	50.6	50.2	49.6	49.1	48.8	48.2	34.5	58.1	52.0	49.4	47.3
Federal Tax Receipts (NIPA)	807.7	826.6	870.4	858.3	867.6	878.5	888.3	867.0	726.5	786.9	826.2	873.1	889.6
% of GNP	19.3	19.5	20.3	19.8	19.8	19.9	19.9	19.2	19.3	19.7	19.6	19.8	19.3
Federal Expenditures (NIPA)	1045.7	1024.0	1059.8	1047.5	1050.0	1061.1	1086.2	1086.1	896.5	984.9	1032.8	1061.2	1110.8
% of GNP	25.0	24.2	24.7	24.2	24.0	24.0	24.3	24.0	23.8	24.6	24.5	24.1	24.1
Deficit(NIPA)	-238.1	-197.4	-189.4	-189.2	-182.4	-182.7	-197.9	-219.1	-170.0	-198.0	-206.6	-188.0	-221.2
% of GNP	-5.7	-4.7	-4.4	-4.4	-4.2	-4.1	-4.4	-4.8	-4.5	-4.9	-4.9	-4.3	-4.8

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
Assumptions and simulations by Dr. Frederick Flick, Janemarie Mulvey, and Sean Burns

Table 2

REAL ESTATE AND FINANCIAL MARKETS

November Iress

	QUARTERS							YEARS				
	Actual		Forecast					Actual		Forecast		
	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single-Family Home Sales (1000's)	4670.5	4784.9	4778.1	4621	4593.3	4541.2	4508.2	4618.5	3932.9	4254.3	4676.5	4565.9	4598.4
(single-family resales and completions)													
Percent Change -- Year Ago	14.5	9.3	5.2	3.3	1.7	5.1	5.6	2.4	4.9	8.2	9.9	2.4	0.7
Existing Single-Family Home Sale(1000's)	3,470	3,616	3,579	3,488	3,469	3,421	3,401	3,464	2,866	3,214	3,481	3,445	3,460
Percent Change -- Year Ago	14.0	7.6	2.3	7.1	0.0	5.4	5.0	1.9	5.5	12.1	8.3	1.0	0.4
Dollar Volume (billions)	349	343	340	332	337	335	330	355	247	291	335	333	351
Existing Home Prices -- Median ($1000's)	82.0	80.2	78.9	81.4	83.9	84.1	82.5	85.9	72.3	75.5	79.8	83.0	86.2
Percent Change -- Year Ago	8.6	4.7	4.9	4.3	2.3	4.9	4.6	4.2	3.6	4.4	5.7	4.0	3.9
Monthly Mortgage Payment (P&I)	587	572	558	545	532	520	519	502	637	609	572	529	514
Percent of Median Family Income	24.8	23.9	22.6	22.5	22.6	22.2	21.3	20.0	28.2	26.2	24.1	22.1	21.1
Housing Starts (1000's)	1,908	1,760	1,788	1,670	1,642	1,650	1,638	1,654	1,763	1,741	1,864	1,650	1,686
Percent Change	9.5	4.3	0.8	-16.4	-14.0	-6.2	-8.4	1.0	3.4	-1.2	7.0	-11.5	2.2
Single-Family Units (1000's)	1,238	1,151	1,189	1,139	1,128	1,140	1,143	1,146	1,100	1,073	1,207	1,137	1,160
Percent Change	15.8	9.8	10.7	-9.1	-8.9	-1.0	-3.8	0.7	3.3	-2.5	12.6	-5.8	2.0
Multi-Family Units (1000's)	670	609	599	532	514	511	494	508	663	669	656	513	527
2-4 Family Units (1000's)	81	77	76	67	65	65	63	64	122	93	84	65	67
Percent Change	20.9	-13.8	-5.0	-34.1	-19.5	-16.2	-17.5	-4.5	7.0	-23.4	-9.9	-22.7	2.7
5+ Family Units (1000's)	590	532	523	464	449	446	432	444	542	576	572	448	463
Percent Change	3.1	-3.2	-15.6	-27.8	-23.9	-16.2	-17.5	-4.5	2.8	6.2	0.6	-21.7	2.8
Mobile Homes Shipped	238	233	244	248	257	268	279	289	295	283	244	263	303
New Single Family Home Sales (1000's)	787	669	635	632	619	602	589	600	637	689	720	610	634
Percent Change -- Year Ago	15.7	-5.9	-8.8	-22.3	-22.2	-11.8	-8.8	-3.6	1.7	8.1	4.6	-15.2	3.9
New Home Prices -- Median ($1000's)	91.4	93.0	94.3	94.4	94.5	94.5	94.5	98.7	80.0	84.3	91.8	94.5	96.4
Percent Change -- Year Ago	8.8	11.5	8.6	6.9	3.4	1.6	0.2	4.4	6.0	5.4	8.9	3.0	2.1
New Home Prices -- Mean ($1000's)	107.8	107.8	110.4	107.6	111.7	111.8	114.6	119.7	96.8	104.0	107.3	111.4	116.1
Percent Change -- Year Ago	3.6	3.4	3.8	4.5	3.6	3.7	3.8	4.4	6.6	7.4	3.1	3.9	4.2
NAR Affordability Index	100.6	104.5	110.2	111.0	110.4	112.5	117.0	125.1	89.1	94.9	103.8	112.7	118.6
Mortgage Debt Outstanding($ billions)	2,389	2,422	2,488	2,556	2,620	2,684	2,748	3,011	1,948	2,202	2,413	2,652	2,911
Housing Inventory (millions)	96.8	97.3	97.7	98.2	98.6	99.0	99.4	101.1	93.4	95.2	97.0	98.8	100.4
Rental Vacancy Rate (%)	7.3	7.1	6.9	6.8	6.7	6.5	6.4	6.0	5.8	6.5	7.1	6.6	6.2
Office Vacancy Rate (%)<1>	16.8	16.8	16.9	17.0	16.8	16.7	16.6	16.4	11.6	14.7	16.5	16.7	16.8
Industrial Vacancy Rate (%) <1>	5.7	5.8	5.7	5.7	5.6	5.6	5.5	5.3	4.9	4.7	5.0	5.6	5.6
FINANCIAL MARKETS													
Money Supply (M1)(% change)	16.8	18.6	12.2	11.8	7.8	7.7	6.5	6.5	7.0	9.1	12.8	11.3	6.7
Velocity of M1 (% change)	-12.2	-10.8	6.4	-6.4	-3.6	-3.0	-2.2	-1.4	3.3	-2.6	-6.6	-6.2	-1.7
Value of the U.S. Dollar (Trade-Weighted)	114.2	108.3	105.0	104.0	103.2	102.6	102.3	100.3	138.3	143.2	111.8	103.0	97.8
Percent Change	-16.5	-19.1	-11.8	-3.8	-3.0	-2.4	-1.1	-7.4	10.4	3.5	-22.0	-7.8	-5.0
Flow of Funds (NIA Basis)													
(Billions of dollars,saar)													
Sources:(total:gross savings)													
Private Saving	719	661	663	685	681	685	696	746	675	688	689	687	757
Personal Saving	153	88	108	118	113	107	110	139	169	143	124	112	136
Savings Rate	5.1	2.9	3.6	3.9	3.7	3.4	3.5	4.3	6.3	5.1	4.2	3.6	4.2
Gross Business Savings	566	573	555	567	568	577	586	608	506	544	566	575	621
Federal Deficit	-238	-197	-189	-189	-182	-183	-198	-219	-170	-198	-207	-188	-221
State & Local	59	62	62	59	56	53	50	49	69	62	63	54	49
Net Foreign Investment	-143	-145	-145	-153	-157	-154	-150	-143	-91	-115	-140	-153	-141
Uses (total:gross investment)	687	675	688	710	706	704	695	716	662	661	690	704	723
Nonresidential Investment	457	457	459	459	455	454	452	452	422	461	458	455	453
Structures	133	130	129	130	130	130	130	130	141	152	135	130	130
Equipment	324	327	329	329	325	324	322	322	281	309	323	325	323
Residential Investment	193	196	195	193	190	189	190	190	171	177	192	191	191
Inventory Investment	15	-5	3	20	17	12	0	15	59	9	13	13	11
Selected Interest Rates (%)													
Mortgage Rates													
30-year Fixed Rate Mortgage	9.9	9.9	9.8	9.6	9.3	9.1	9.0	8.9	13.8	12.2	10.0	9.3	8.7
Real Mortgage Rate	4.4	4.6	4.7	4.9	4.9	5.1	5.3	5.4	6.4	5.5	4.5	5.3	5.4
1-year ARM (without buydown)	8.3	7.7	7.5	7.3	7.0	6.8	6.7	6.6	12.6	10.1	8.1	7.1	6.5
Real Mortgage Rate	3.2	2.7	2.5	5.7	2.9	3.0	3.2	3.4	5.2	3.4	2.8	3.1	3.6
Corporate AAA Bond Rate	9.0	8.8	8.8	8.5	8.2	8.0	7.9	7.8	12.7	11.4	9.0	8.1	7.5
Government Bond Rate	7.5	7.4	7.6	7.4	7.0	6.8	6.7	6.7	12.4	10.8	7.8	7.0	6.5
Federal Funds Rate	6.9	6.2	5.8	5.5	5.4	5.2	5.1	5.1	10.2	8.1	6.7	5.3	5.0
3-month T-Bill Rate	6.1	5.5	5.2	5.0	4.9	4.7	4.5	4.4	9.5	7.5	5.9	4.8	4.6
Real 3-month T-Bill Rate	4.3	1.9	3.5	2.0	2.2	1.6	1.6	1.2	5.6	4.2	3.2	2.0	1.4
1-Year T-Bill Rate	6.6	6.0	5.8	5.6	5.3	5.1	5.0	4.9	10.9	8.4	6.4	5.4	4.8
Real 1-Year T-Bill Rate	4.8	2.4	4.0	2.5	2.7	2.1	2.1	1.7	6.1	4.7	3.7	2.5	1.9
Prime Rate	8.6	7.9	7.5	7.3	7.1	6.9	6.7	6.4	12.0	9.9	8.3	7.0	6.2
Discount Rate	6.6	5.8	5.5	5.2	5.0	4.8	4.6	4.8	8.8	7.7	6.3	4.9	4.7

<1> Historical Data courtesy of Coldwell Banker.
<2> FHA Secondary Mortgage Market Rate
<3> Real Interest Rates = Nominal Interest Rates - Expected Rate of Inflation.

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
Assumptions and simulations by Dr. Frederick Flick, Janemarie Mulvey, and Sean Burns

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Outlook for the Economy and Real Estate

Forecasting & Policy
Analysis Division
NATIONAL ASSOCIATION OF REALTORS®
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The Outlook for the Economy and Real Estate

Growth in GNP and its Components

Growth in the economy should rebound modestly in the fourth quarter as the trade sector exerts a positive influence on economic activity for the first time since March. Contributing to this improvement, oil imports are expected to decline significantly during the fourth quarter after rising sharply earlier this year. At the same time, exports are expected to register another solid gain. As a result, export growth net of imports should add over one full percentage point to GNP growth. Further, spending and investment will likely be fueled by taxpayers' efforts to take advantage of expiring provisions in the tax code. Consumer's will accelerate purchases of "big ticket" items in order to deduct the sales tax before year end. Similarly, businesses will attempt to complete construction projects before the 1987 deadline when depreciation schedules will be lengthened. However, this rebound in the fourth quarter reflects temporary factors and does not indicate any underlying strength in economic activity. Consequently, while growth is expected to increase 3.0 percent during the fourth quarter, this rebound in economic activity will be short lived and, by 1987, growth in the economy is expected to slow considerably.

The outlook for 1987 will be characterized by transition as many sectors of the economy adjust to tax reform and an aging recovery. The spending binge of the past 2 years will likely come to an end next year as a debt-burdened consumer attempts to replenish his savings and pay off his loans. Growth in nonresidential investment will be virtually non-existent in 1987 because a large part of the declines occurred in 1986 in anticipation of tax reform. The major stimulus to growth in 1987 will come from the trade sector as the impact of a depreciating dollar will likely boost import prices relative to the prices of their domestic counterparts. As U.S. manufacturers regain their competitive edge, export growth is expected to finally outpace import growth next year leading to a long-awaited turnaround in the nation's trade performance. Growth in real GNP is likely to remain below two percent for the first half of 1987 before rebounding modestly late in the year. For all of 1987, real GNP is expected to increase 2.2 percent. By 1988, real GNP growth should improve increasing at a rate of 2.9 percent.

Unemployment and Inflation

The unemployment rate in November remained unchanged at 7.0 percent while nonfarm payroll employment increased a strong 249,000 jobs. While job gains continued to be concentrated in the service sector, employment within the manufacturing sector grew for the second consecutive month. A large part of this gain in employment occurred in the export-oriented industries. This is consistent with our fourth quarter projections of strong growth in the export sector. As growth slows in 1987, the unemployment rate is expected to rise above 7.0 percent as job-seekers outpace job openings.

Inflation and Prices

While there will be two opposing forces affecting inflation next year the dominant pressures will be downward. The major factor restraining inflation in 1987 will most likely be lower labor costs which currently comprise over two-thirds of total costs. At the same time, however, the effect of the declines in the dollar and the expected run-up in oil prices, should put upward pressure on overall prices. Consequently, consumer price inflation is expected to increase a modest 3.1 percent in 1987, compared to the 2.0 percent rate projected for 1986.

Interest Rates

The bond market continues to rally as monthly indicators continue to point to slower growth in the months ahead. Consequently, long-term interest rates declined by over 50 basis points since mid-November. In addition, the latest banking figures released by the Federal Reserve Board (Fed) show that the Fed has been especially generous in supplying reserves to the banking system in an effort to alleviate pressures caused by seasonal and technical factors. However, despite news of slowing growth, the Fed will move cautiously to lower interest rates, and a discount rate cut is not expected until early next year. Therefore, during the fourth quarter, both long- and short-term interest rates are expected to remain stable.

By 1987, fiscal policy will play a major role in exerting downward pressure on interest rates. Attempts by Congress to reduce the deficit through adherence to Gramm-Rudman-Hollings deficit targets has sent a positive signal to the financial markets that future deficits will, at the very least, decline. Further, tax reform, because it dampens investment and provides disincentives to borrowing, will reduce the demand for loanable funds thus, easing credit conditions. As a result, both long- and short-term interest rates are expected to trend slowly downward through next year. However, by 1988, the path of short- and long-term interest rates should diverge. As long-term interest rates begin to stabilize, short-term interest rates should begin to edge upward as renewed vigor in the economy and a modest acceleration in prices signals caution to the Federal Reserve.

As investors seek higher yields and mortgage securities continue to record outstanding performance in the mortgage securities markets, the spread between long-term treasury bond rates and mortgage rates should begin to narrow. Consequently, mortgage rates will likely continue to decline through 1987, dipping below 8.5 percent by year end.

Real Estate Markets

Existing homes continued to be sold at a healthy pace. In September and October, over 3.7 million homes were sold, the fastest pace in 7 years. New construction, on the other hand, is beginning to feel the bite of tax reform. Both single and multi-family starts have recorded sharp declines over the past few months. These trends are likely to continue. With mortgage interest rates expected to decline to 8.5 percent by mid-1987, sales of existing homes should remain at a healthy pace despite slower growth and tax reform. In 1987, over 3.5 million homes are expected to be sold. However, new construction is not expected to fare as well, largely due to tax reform. Single family starts are expected to decrease by over 7 percent, while multi-family starts are expected to decline over 20 percent.

The rate of appreciation of home prices will also differ depending on whether they are existing or new homes. The existing home median price should continue to outpace inflation next year increasing by 4.0 percent. New homes, however, will face a tighter market. Until recently, the demand for new construction has been strong enough to support large profits. However, with demand subsiding from its heated pace of early 1986, buyers will become more price resistant. Therefore, builders will likely have to moderate prices in an effort to sustain new home sales and starts. Consequently, new home prices are expected to appreciate less than 3.0 percent next year.

Table 1

DECEMBER 1986

U.S. ECONOMIC OUTLOOK

	QUARTERS							YEARS				
	Actual		Forecast					Actual		Forecast		
	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1984	1985	1986	1987	1988
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4,176	4,241	4,297	4,342	4,394	4,451	4,514	4,582	3,765	3,998	4,216	4,425	4,688
% Change	2.6	6.4	5.4	4.3	4.8	5.4	5.7	6.1	10.5	6.2	5.4	5.0	5.9
% Change (w/out inflation)	0.6	2.9	3.0	1.7	1.9	2.7	2.5	3.0	6.4	2.7	2.6	2.2	2.9
Consumption	6.2	6.5	1.5	2.2	1.5	1.7	1.3	1.7	4.7	3.5	4.0	2.0	1.7
Durables	14.3	39.7	21.2	1.4	0.6	1.1	2.0	0.7	12.7	7.8	5.9	1.2	2.1
Nondurables	8.0	1.1	2.3	2.0	1.4	1.6	1.2	1.9	3.6	1.6	3.7	1.8	1.6
Services	2.6	3.4	2.8	2.5	1.9	2.0	1.2	1.9	3.4	3.7	3.5	2.4	1.7
Residential Investment	14.5	9.7	8.6	8.7	7.2	1.2	6.1	3.1	14.3	3.9	8.5	2.8	1.0
Nonresidential Investment	0.9	0.1	1.9	0.7	0.0	0.5	2.5	0.1	16.9	9.3	0.8	0.3	1.5
Structures	35.2	8.2	2.5	1.2	0.9	0.9	0.6	0.3	11.1	7.7	11.2	4.7	1.6
Equipment	19.6	3.4	3.7	0.5	0.3	0.4	3.7	0.0	20.0	10.1	4.3	2.4	1.5
Exports	9.8	9.3	8.3	8.9	11.3	15.3	14.4	13.7	6.2	2.0	1.6	9.2	13.1
Imports	15.8	14.7	2.9	1.7	1.1	3.6	0.3	2.8	23.2	3.8	9.9	3.2	2.6
Government Purchases	9.7	7.6	7.1	5.3	1.1	4.5	8.3	5.2	4.0	6.8	3.7	2.7	1.9
Contribution to GNP Growth (Percentage Points)													
Consumption	4.0	4.3	1.0	1.4	1.0	1.1	0.9	1.1	2.4	2.3	2.4	1.1	1.3
Residential Investment	0.7	0.5	0.5	0.5	0.4	0.1	0.3	0.2	0.2	0.4	0.3	0.1	0.0
Nonresidential Investment	0.1	0.0	0.2	0.1	0.0	0.1	0.3	0.0	1.7	0.8	0.5	0.1	0.2
Structures	1.7	0.3	0.1	0.0	0.0	0.0	0.0	0.0	0.5	0.1	0.6	0.0	0.1
Equipment	1.6	0.3	0.3	0.0	0.0	0.0	0.3	0.0	1.2	0.7	0.1	0.1	0.1
Inventory Change	2.7	2.3	1.6	1.4	0.1	0.5	2.0	2.0	0.2	1.1	0.4	0.3	0.4
Net Exports	3.0	1.1	1.2	0.6	1.0	1.0	1.4	1.1	1.4	1.1	0.6	1.0	0.8
Government Purchases	1.9	1.5	1.4	1.1	0.2	0.9	1.6	1.1	1.5	1.6	0.5	0.4	0.3
Mfg. Capacity Utilization	79.5	79.8	79.6	79.1	78.6	78.5	78.3	78.3	80.8	80.3	79.7	78.6	78.2
Domestic Auto Sales	8.1	9.7	7.1	6.9	7.3	7.1	7.2	7.0	8.0	8.2	8.2	7.1	7.2
Personal Income Per Household	41,967	42,100	42,489	42,945	43,340	43,757	44,208	44,788	36,800	40,557	42,295	43,870	45,874
Percent Change	4.7	3.9	4.0	2.3	2.9	3.0	2.9	3.3	6.6	10.2	4.3	3.7	4.6
Personal Taxes Per Household	6,082	6,239	6,312	6,171	6,252	6,338	6,425	6,187	5,201	5,953	6,204	6,340	6,386
Percent Change	9.6	4.5	3.1	1.5	0.2	0.4	4.1	1.1	6.2	14.5	4.2	2.2	0.7
Percent of Disposable Income	14.49	14.82	14.86	14.37	14.43	14.49	14.53	13.81	14.13	14.68	14.67	14.45	13.92
Disposable Personal Income Per Household	35,886	35,862	36,177	36,774	37,088	37,419	37,783	38,601	31,598	34,604	36,092	37,529	39,488
Percent Change	5.0	3.0	3.8	2.5	3.4	3.4	2.7	4.1	3.2	9.5	4.3	4.0	5.2
Employment (millions) (civilian household basis)	109.2	110.0	110.3	110.5	110.9	111.2	111.6	111.9	105.0	107.2	109.6	111.1	112.6
% Change	1.7	2.8	1.1	1.0	1.2	1.3	1.3	1.2	4.1	2.1	2.2	1.4	1.4
Unemployment Rate (%) (civilian household)	7.2	6.9	7.0	7.1	7.2	7.2	7.1	7.1	7.5	7.2	7.0	7.1	6.9
Consumer Prices (CPI)	1.7	2.6	4.2	3.0	3.5	3.2	4.2	3.6	4.3	3.5	2.0	3.1	3.7
GNP Deflator	1.8	3.6	2.4	2.5	2.9	2.6	3.1	3.1	3.9	3.3	2.8	2.7	3.0
Personal Cons. Inflation	1.1	3.2	3.6	3.0	3.5	3.2	4.0	3.5	3.8	3.5	2.1	3.1	3.6
Residential Construction Inflation	5.6	2.9	3.0	2.2	3.9	3.7	3.5	3.3	4.1	1.8	3.4	3.2	3.8
Nonresidential Const. Inflation	0.4	2.8	4.5	2.6	3.0	2.2	2.8	2.7	0.2	0.7	1.5	2.8	2.8
Producer Price Inflation	5.5	0.4	4.3	3.8	4.1	3.6	4.2	4.0	2.1	0.9	1.4	2.9	4.1
Before Tax Corporate Profit	231.3	241.3	280.6	280.2	285.0	289.8	302.8	304.1	235.7	225.1	244.4	289.5	309.7
Corporate Tax Liability	93.3	97.3	132.6	142.9	147.0	148.8	154.1	146.7	95.4	91.7	103.1	148.2	148.9
After Tax Profits	138.0	144.0	148.0	137.3	138.0	141.0	148.7	157.4	140.3	133.4	141.3	141.3	160.8
Inventory Valuation Adjustment	10.6	8.0	6.3	2.5	7.2	7.0	10.5	8.8	5.5	0.5	7.2	6.8	10.9
Capital Consumption Allowance	51.3	50.2	49.1	36.9	36.6	36.8	36.7	36.7	34.5	58.1	51.5	36.8	36.2
Federal Tax Receipts (NIPA)	807.7	826.1	867.6	874.3	887.3	898.7	913.1	897.8	726.5	786.9	825.3	893.4	922.3
% of GNP	19.3	19.5	20.2	20.1	20.2	20.2	20.2	19.6	19.3	19.7	19.6	20.2	19.7
Federal Expenditures (NIPA)	1045.7	1031.9	1052.0	1054.7	1058.9	1071.7	1093.3	1096.3	896.5	984.9	1032.8	1069.6	1114.5
% of GNP	25.0	24.3	24.5	24.3	24.1	24.1	24.2	23.9	23.8	24.6	24.5	24.2	23.8
Deficit(NIPA)	-238.1	-205.8	-184.4	-180.4	-171.6	-173.0	-180.2	-198.5	-170.0	-198.0	-207.5	-176.3	-192.2
% of GNP	5.7	4.9	4.3	4.2	3.9	3.9	4.0	4.3	4.5	4.9	4.9	4.0	4.1

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy
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Table 2

REAL ESTATE AND FINANCIAL MARKETS

DECEMBER 1986

	Actual		QUARTERS Forecast						YEARS Actual		YEARS Forecast		
	1986.2	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1984	1985	1986	1987	1988
REAL ESTATE MARKETS													
Total Single Family Home Sales (single family resales and completions)	4.669	4.725	4.824	4.624	4.572	4.666	4.741	4.775	3.933	4.254	4.672	4.651	4.702
Percent Change -- Year Ago	14.5	8.0	6.2	5.3	-2.1	4.6	2.4	0.5	4.9	8.2	9.8	-0.4	1.1
Existing Single Family Home Sales (1000's)	3,470	3,616	3,731	3,590	3,534	3,578	3,643	3,651	2,866	3,214	3,519	3,586	3,593
Percent Change -- Year Ago	14.0	7.6	6.6	10.2	1.8	1.1	-2.4	2.3	5.5	12.1	9.5	1.9	0.2
Dollar Volume (billions)	349	343	349	349	343	335	350	359	247	291	337	344	363
Existing Home Prices -- Median ($1000's)	82.0	80.2	79.4	81.4	83.9	84.6	83.0	84.7	72.3	75.5	79.9	83.1	86.3
Percent Change -- Year Ago	8.6	4.7	5.6	4.3	2.3	4.8	4.5	4.0	3.6	4.4	5.8	4.0	3.9
Monthly Mortgage Payment (P&I,30 yr.)	587	572	559	544	520	509	497	496	619	609	575	517	499
Percent of Median Family Income	24.8	23.9	22.7	22.6	22.3	21.7	21.0	20.7	28.2	26.2	24.1	21.9	20.5
Housing Starts (1000's)	1,908	1,746	1,677	1,554	1,563	1,615	1,633	1,610	1,763	1,741	1,833	1,591	1,627
% Change	9.5	3.5	-5.4	-22.2	18.1	7.5	2.6	3.6	3.4	1.2	5.2	13.2	2.2
Single-Family Units (1000's)	1,238	1,144	1,127	1,067	1,072	1,122	1,133	1,140	1,100	1,073	1,191	1,098	1,132
% Change	15.8	9.2	5.0	-14.9	13.4	1.9	0.5	6.9	3.3	-2.5	11.0	7.7	3.1
Multi-Family Units (1000's)	670	602	550	487	491	493	500	471	663	669	642	493	495
2-4 Family Units	81	75	69	61	62	62	63	59	122	93	82	62	62
% Change	20.9	-15.7	-13.7	-40.2	23.8	18.2	9.1	3.4	7.6	-23.4	12.2	-24.5	0.4
5+ Family Units	590	527	481	426	430	431	437	412	542	576	560	431	433
% Change	3.1	4.2	-22.4	-33.8	-27.1	18.1	9.1	3.4	2.8	6.2	-2.7	-23.0	0.4
Mobile Homes Shipped	238	233	237	240	250	266	278	288	295	283	242	258	298
New Single Family Home Sales (1000's)	737	682	659	648	642	669	675	684	637	689	732	659	662
Percent Change -- Year Ago	15.7	4.1	5.3	-1.9	18.4	1.9	2.4	5.6	1.7	8.4	6.6	9.2	0.4
New Home Prices -- Median ($1000)	91.9	92.3	92.9	93.1	93.5	93.7	94.1	94.6	80.0	84.3	91.4	93.6	96.0
Percent Change -- Year Ago	9.4	10.7	7.0	5.4	1.7	1.5	1.3	1.6	6.0	5.4	8.4	2.4	2.6
New Home Prices -- Average ($1000's)	107.8	107.8	110.4	107.6	111.7	111.8	114.6	111.9	96.8	104	107.3	111.4	116.1
Percent Change -- Year Ago	3.6	3.4	3.8	4.5	3.6	3.7	3.8	4.0	6.6	7.4	3.2	3.8	4.2
NAR Affordability Index	100.5	104.5	111.0	112.6	114.7	115.1	118.9	120.5	75.4	85.9	103.7	114.1	122.0
Mortgage Debt Outstanding($ billions)	2,389	2,422	2,488	2,546	2,606	2,667	2,730	2,793	1,948	2,202	2,413	2,637	2,896
Housing Inventory (millions)	96.5	97.3	97.7	98.2	98.6	99.0	99.4	99.8	93.4	95.2	97.0	98.8	100.4
Rental Vacancy Rate (%)	7.3	7.1	6.9	6.8	6.7	6.5	6.4	6.3	5.8	6.5	7.1	6.6	6.2
Office Vacancy Rate (%)<1>	16.8	16.8	16.9	17.0	16.8	16.7	16.6	16.6	14.7	16.5	16.7	16.6	16.5
Industrial Vacancy Rate (%) <1>	5.7	5.8	5.7	5.7	5.6	5.6	5.5	5.5	4.7	5.0	5.6	5.6	5.4
FINANCIAL MARKETS													
Money Supply (M1)(% change)	16.8	18.4	14.8	11.0	8.1	8.5	7.5	6.8	7.0	9.1	13.0	11.8	6.8
Velocity of M1 (% change)	-12.2	-10.1	-8.2	-6.1	-3.0	-2.9	-1.7	-0.3	-3.3	-2.6	-6.6	-6.2	-0.8
Value of the U.S. Dollar (Trade-Weighted)	114.2	108.3	107.3	106.3	105.4	104.6	104.2	102.3	138.3	143.2	112.4	105.1	100.1
Percent Change	-16.5	-19.1	-3.7	-3.8	-3.3	-3.1	-1.5	-7.2	10.4	3.5	-21.6	-6.4	-4.8
Flow of Funds (NIA Basis) (Billions of dollars,saar)													
Sources:(total gross savings)													
Private Saving	719	662	675	682	681	689	697	750	675	688	693	687	760
Personal Saving	153	90	108	128	124	123	120	157	169	143	124	124	156
Savings Rate	5.1	3.0	3.6	4.2	4.0	3.9	3.8	4.8	6.3	5.1	4.2	4.0	4.7
Gross Business Savings	566	571	567	554	557	566	576	593	506	544	568	563	604
Federal Deficit	-238	-206	-184	-180	-172	-173	-180	-199	-170	-198	-208	-176	-192
State & Local	59	64	63	61	59	56	55	55	69	62	64	58	55
Net Foreign Investment	-143	-145	-143	-142	-145	-144	-139	-127	-91	-115	-140	-142	-122
Uses (total gross investment)	687	675	696	707	709	711	702	729	662	661	692	707	741
Nonresidential Investme	457	457	459	458	458	459	461	462	422	461	458	459	466
Structures	133	130	129	129	129	129	129	129	141	152	135	129	131
Equipment	324	327	330	329	329	330	333	333	281	309	322	330	335
Residential Investment	193	197	193	189	185	186	188	190	171	177	192	187	189
Inventory Investment ($ billions)	15	-6	9	21	22	18	-1	17	59	9	15	15	17
Selected Interest Rates (%)													
Mortgage Rates													
30-year Fixed Rate Mortgage<2>	9.9	9.9	9.5	9.2	9.0	8.7	8.6	8.5	13.8	12.2	9.9	8.9	8.5
Real Mortgage Rate	4.4	4.8	4.7	4.7	4.8	4.7	4.9	5.0	6.4	5.5	4.6	4.8	5.3
1-year ARM (without buydown)	7.9	7.3	7.2	6.9	6.7	6.3	6.3	6.3	12.5	10.0	7.9	6.5	6.4
Real Mortgage Rate	5.5	4.8	4.5	4.2	3.9	3.4	3.2	3.1	5.6	5.2	5.0	3.7	3.4
Corporate AAA Bond Rate	9.0	8.8	8.6	8.4	8.1	7.9	7.8	7.6	12.7	11.4	9.0	8.1	7.5
Government Bond Rate	7.5	7.4	7.3	7.2	6.9	6.7	6.6	6.6	12.4	10.8	7.7	6.8	6.5
Federal Funds Rate	6.9	6.2	6.0	5.7	5.4	5.2	5.2	5.3	10.2	8.1	6.7	5.4	5.4
3-month T-Bill Rate	6.1	5.5	5.4	5.1	4.9	4.5	4.5	4.5	9.5	7.5	6.0	4.7	4.6
Real 3-month T-Bill Rate	3.7	3.0	2.8	2.4	2.1	1.6	1.4	1.4	5.6	4.2	3.2	1.9	2.0
1-Year T-Bill Rate	6.3	5.7	5.6	5.3	5.1	4.7	4.7	4.7	10.9	8.4	6.3	4.9	4.8
Real 1-Year T-Bill Rate	3.9	3.2	2.9	2.6	2.3	1.8	1.6	1.5	6.1	4.7	3.3	2.1	2.2
Prime Rate	8.6	7.9	7.5	7.4	7.2	6.9	6.7	6.7	12.0	9.9	8.3	7.0	7.0
Discount Rate	6.6	5.8	5.5	5.2	5.1	4.8	4.6	4.6	8.8	7.7	6.3	4.9	4.9

<1> Historical Data courtesy of Coldwell Banker.
<2> FHA Secondary Mortgage Market Rate
<3> Real Interest Rates - Nominal Interest Rates - Expected Rate of Inflation.

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. Frederick Flick, Janemarie Mulvey, and Sean Burns

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Outlook for the Economy and Real Estate

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THE OUTLOOK FOR THE ECONOMY AND REAL ESTATE

Eager for good news on the prospects for continued economic growth in 1987, many analysts have seized upon early reports of renewed vigor in retail sales, stronger production and gains in employment as signs of a wonderful year to come. If the truth be told, sales strength in late 1986 was mostly made up of consumers racing to beat the deadline for deductibility of state sales taxes, which depleted auto inventories (among other items), and caused the higher production seen this quarter. The employment progress was mostly explained by striking manufacturing workers returning to work. But while the overall economic growth rate during 1987 will be sluggish at about 2.0 percent, the housing industry, with the exception of multi-family construction, can expect to enjoy another good year.

A closer look at the composition of the slower GNP growth helps to point out the changing forces in the economy that will drive growth in 1987. Up until now, consumption has been the engine of growth as the American consumer has been willing and able to spend. Today, slower growth in personal income has forced the previously "able" consumers to come face to face with the consequences of their spending: high debt burdens and low savings. Even consumers that are still "able" may be less "willing" because the new tax law raises the price of consumption by eliminating the deduction for sales taxes and phasing out the one for consumer interest.

Without the consumption impetus, the prospects for positive growth hinge on a long-awaited turnaround in the U.S. trade balance. The dollar has declined substantially against the currencies of many of our trading partners. This has caused the differentials in labor cost between the U.S. and Japan (among others) to narrow sharply and has begun to reverse the trade imbalance. Moreover, the usual lag between currency value changes and changes in trade flows have about worked their way through the system. All this means that trade should finally contribute positively to GNP growth during 1987 and help to offset declines in the growth of consumer spending.

The key to this outlook for 1987 is the conduct of monetary policy. Lately, the Fed has been most concerned with the slow rate of growth in GNP, encouraging interest rates to fall in order to coax more investment from the economy. The burden on monetary policy is heavy, since massive budget deficits have removed government spending as a means of boosting the economy. But the current monetary policy has had the pleasant side effect of pulling the value of the U.S. dollar down slowly—something the governments of the U.S., Britain, Japan, W. Germany, and France had agreed to pursue together in September 1985, in the hope of resolving world trade imbalances.

But in the last several weeks a seed of doubt has been sown about the Fed's stance on monetary policy. The Fed has now to contend not only with sluggish economic growth, but also with a dollar that is beginning to fall a bit too fast. Complicating the situation is a new stage of the third-world debt crisis and a new round of negotiations between debt-strapped developing countries and their creditors. In all likelihood, the Fed will remain committed to supporting U.S. economic growth, but will probably work with foreign governments to stabilize the dollar's value. This accommodative policy suggests that more inflation could be on the horizon. With oil prices firming up in the $17 to $19 per barrel range, inflation will top 3 percent in 1987 and 1988.

Real Estate Markets

Sales of existing single-family homes closed out 1986 at a strong annual rate of 4.17 million units in December. This brought the 1986 sales total to 3.57 million units representing more than a 10 percent gain over 1985 sales performance. In February, existing single-family home sales reached 3.69 million units. Existing home sales activity will likely show a moderating trend in this first quarter of 1987 to about 3.59 million units, but will gain momentum throughout the year as interest rates stay moderate. Total existing single-family home sales for 1987 should reach 3.62 million units.

Housing starts activity trailed off a bit in January after a very strong 10.8 percent advance in December 1986, but a large part of the January decline was due to continued weakness in multi-family starts. Housing starts rebounded in February by 2.6 percent, and single-family starts rose strongly by 5.6 percent. The new tax law will keep multi-family starts down to about a 500 thousand unit rate during 1987. The good news is that single-family starts should remain very strong in both 1987 and 1988 owing to low interest rates.

Sales of new single-family homes shot up 12.1 percent last December, but then trailed off by 6.8 percent in January of this year, due mostly to the large December rise. The prices of both new and existing single-family homes will still increase at healthy rates over the forecast horizon. Homeowners can expect to see their homes rise in value by an average rate of 4 percent. This rise in prices is a normal consequence of declining interest rates. This means that despite today's lower interest rates, it is possible that housing affordability could rise slowly or stabilize in the next two years and could even decline somewhat.

Table 1

U.S. ECONOMIC OUTLOOK

	QUARTERS							YEARS			
	Actual		Forecast					Actual		Forecast	
	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1988.2	1985	1986	1987	1988
AGGREGATE ECONOMY												
Gross National Product (billions of dollars)	4240.7	4260.6	4318.8	4374.7	4432.9	4495.6	4564.4	4626.6	3998.1	4206.5	4405.5	4651.0
% Change	6.4	1.9	5.6	5.3	5.4	5.8	6.3	5.6	6.2	5.2	4.7	5.6
% Change (w/out inflation)	2.8	1.3	2.0	1.9	2.6	2.7	3.1	2.5	2.7	2.5	2.0	2.5
Consumption	6.7	-0.1	-1.5	2.8	3.8	0.3	2.3	1.7	3.5	4.1	1.8	1.8
Durables	46.6	-10.0	-24.1	1.6	12.8	-6.6	5.0	2.4	7.8	7.3	-2.2	2.1
Nondurables	-0.9	-0.2	2.7	3.0	2.3	1.5	1.9	1.5	1.6	3.6	1.9	1.8
Services	2.4	3.4	3.6	3.0	2.3	1.5	1.9	1.5	3.7	3.4	2.9	1.8
Residential Investment	9.7	6.2	1.7	-3.6	-3.6	0.9	0.3	1.3	3.9	9.5	2.5	-0.7
Nonresidential Investment	-2.1	1.3	-3.5	0.6	2.2	1.4	3.7	3.0	9.3	-1.1	-0.5	2.3
Structures	-9.8	-7.2	-1.1	1.7	2.2	0.8	2.9	2.8	7.7	-11.7	-5.1	1.9
Equipment	1.2	4.9	-4.4	0.2	2.2	1.7	4.0	3.1	10.1	4.1	1.4	2.4
Exports	13.3	13.6	8.2	7.4	7.2	7.0	7.3	7.0	-2.0	2.4	8.2	7.1
Imports	17.3	-0.2	1.5	2.8	2.5	0.4	3.0	1.8	3.8	10.4	4.1	1.9
Government Purchases	4.5	11.0	-4.5	-0.6	3.2	7.8	-3.9	2.4	6.8	3.6	2.7	2.3
Contribution to GNP Growth (Percentage Points)												
Consumption	4.4	-0.1	-1.0	1.8	2.5	0.2	1.5	1.1	2.3	2.6	0.9	1.0
Residential Investment	0.5	0.3	0.1	-0.2	-0.2	0.0	0.0	0.1	0.4	0.5	-0.1	0.0
Nonresidential Investment	-0.3	0.2	-0.4	0.1	0.3	0.2	0.4	0.4	0.8	-0.6	0.0	0.3
Structures	-0.4	-0.3	0.0	0.1	0.1	0.0	0.1	0.1	0.1	-0.7	0.0	0.0
Equipment	0.1	0.4	-0.4	0.0	0.2	0.1	0.3	0.3	0.7	0.1	0.0	0.2
Inventory Change	-1.7	-2.6	3.7	0.0	-1.0	0.0	1.6	0.0	-1.1	-0.5	0.7	0.1
Net Exports	-1.0	1.3	0.6	0.4	0.4	0.7	0.3	0.5	-1.1	-0.5	0.5	0.5
Government Purchases	0.9	2.2	-1.0	-0.1	0.7	1.6	-0.8	0.5	1.6	0.6	0.3	0.5
Mfg. Capacity Utilization	79.7	79.8	80.2	80.0	79.8	79.7	79.7	79.5	80.3	79.7	79.9	79.2
Domestic Auto Sales	9.7	7.9	7.0	7.3	7.9	7.3	7.4	7.4	8.2	8.4	7.3	7.3
Personal Income	3498.8	3529.6	3573.0	3616.6	3661.5	3707.6	3764.6	3810.9	3314.5	3486.1	3639.7	3834.8
Percent Change	5.3	4.3	4.1	3.8	4.7	5.0	5.4	5.4	6.6	5.2	4.4	5.4
Disposable Personal Income	2979.9	2994.6	3048.0	3082.6	3118.6	3155.4	3213.4	3250.4	2828.0	2972.0	3101.1	3269.4
Percent Change	5.2	3.9	3.8	3.5	4.7	5.4	5.4	5.4	5.9	5.1	4.3	5.4
Employment (millions) (civilian:household basis)	110.0	110.4	111.1	111.4	111.8	112.2	112.6	113.0	107.2	109.6	111.6	113.1
% Change	2.7	1.6	2.5	1.2	1.4	1.4	1.3	1.5	2.0	2.3	1.9	1.3
Unemployment Rate (%) (civilian:household)	6.9	6.8	6.8	6.9	7.0	7.0	7.0	6.9	7.2	7.0	6.9	6.9
Consumer Prices (CPI)	2.6	2.5	4.2	3.4	3.3	3.6	3.5	3.6	3.5	1.9	3.0	3.5
GNP Deflator	3.6	0.7	3.5	3.3	2.8	3.0	3.0	3.0	3.3	2.6	2.7	3.0
Personal Cons. Inflation	3.6	3.2	4.2	3.7	3.1	3.5	3.3	3.4	3.5	2.1	3.3	3.3
Residential Construction Inflation	1.8	2.9	4.0	4.0	3.6	4.1	3.0	4.2	1.8	3.3	3.6	3.7
Nonresidential Construction Inflation	3.2	0.8	2.3	3.4	2.8	3.1	3.0	2.9	0.7	1.4	2.3	3.0
Producer Price Inflation	-0.1	2.5	3.7	4.1	3.9	4.0	3.8	4.0	0.9	-1.4	2.6	4.0
Before Tax Corporate Profit	240.4	250.9	249.4	255.4	255.7	267.0	266.4	270.2	229.1	235.4	256.9	265.3
Corporate Tax Liability	104.5	109.0	131.7	136.5	136.5	141.3	134.9	136.5	...7	102.0	136.5	134.9
After Tax Profits	135.9	141.9	117.7	118.9	119.2	125.7	131.5	133.7	131.4	133.4	120.4	130.4
Inventory Valuation Adjustment	6.1	-7.2	-4.3	-4.9	-3.4	-6.0	-4.7	-7.8	-0.5	6.5	-4.6	-7.1
Capital Consumption Allowance	55.5	59.4	57.6	55.8	54.8	53.9	53.2	52.5	58.1	56.8	55.5	52.1
Federal Tax Receipts (NIPA)	833.1	849.6	870.2	884.9	895.0	909.3	912.3	927.5	786.9	825.7	889.9	933.0
% of GNP	19.6	19.9	20.1	20.2	20.2	20.2	20.0	20.0	19.7	19.6	20.2	20.1
Federal Expenditures (NIPA)	1030.5	1045.5	1048.0	1052.9	1065.1	1087.0	1092.3	1103.8	984.9	1030.8	1063.3	1115.3
% of GNP	24.3	24.5	24.3	24.1	24.0	24.2	23.9	23.9	24.6	24.5	24.1	24.0
Deficit(NIPA)	-197.4	-195.9	-177.8	-168.0	-170.0	-177.7	-180.0	-176.3	-198.0	-205.1	-173.4	-182.3
% of GNP	-4.7	-4.6	-4.1	-3.8	-3.8	-4.0	-3.9	-3.8	-4.9	-4.9	-3.9	-3.9

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr. Frederick Flick, Janemarie Mulvey and Sean Burns.

Table 2

March-April 1987

REAL ESTATE AND FINANCIAL MARKETS

	QUARTERS							YEARS			
	Actual		Forecast					Actual		Forecast	
	1986.3	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1988.2	1985	1986	1987	1988
REAL ESTATE MARKETS												
Total Single-Family Home Sales (single-family resales and completions)	4732	5011	4735	4712	4760	4765	4773	4787	4255	4723	4743	4697
Percent Change -- Year Ago	8.1	10.3	5.9	0.9	-0.5	-4.9	0.8	1.6	8.2	11.0	0.4	-1.0
Existing Single-Family Home Sales (1000's)	3616	3890	3590	3615	3638	3649	3651	3659	3215	3565	3623	3590
Percent Change -- Year Ago	7.6	12.7	10.2	4.2	0.6	-6.2	1.7	1.2	12.1	10.9	1.6	-0.9
Dollar Volume (billions)	359	393	349	356	353	359	359	352	291	343	355	363
Existing Home Prices -- Median ($1000's)	80.2	80.7	81.4	83.9	84.2	84.9	84.7	87.3	75.5	80.3	83.6	86.9
Percent Change -- Year Ago	4.7	5.6	4.3	2.3	5.0	5.2	4.1	4.0	4.4	6.4	4.1	3.9
Monthly Mortgage Payment (P&I, 30 yr.)	568	571	552	555	547	546	540	557	609	681	592	564
Percent of Median Family Income	23.7	23.7	22.7	22.5	22.0	21.8	21.2	21.7	26.2	23.7	23.9	21.9
Housing Starts (1000's)	1758.3	1700.7	1706.5	1622.9	1635.8	1628.5	1619.4	1643.3	1741.3	1841.3	1648.4	1617.8
% Change	4.2	-4.1	-14.6	-14.9	-7.0	-4.2	-5.1	1.3	-1.2	5.7	-10.5	-1.9
Single-Family Units (1000's)	1150.0	1156.0	1180.3	1130.8	1157.1	1150.3	1156.6	1162.8	1072.5	1199.1	1154.6	1141.5
% Change	9.7	7.6	-5.8	-8.6	0.6	-0.5	-2.0	2.8	-2.5	11.8	-3.7	-1.1
Multi-Family Units (1000's)	608.3	544.7	526.2	492.1	478.7	478.2	462.8	480.5	668.8	642.3	493.8	476.3
2-4 Family Units	76.7	88.3	85.4	79.8	77.6	77.6	75.1	77.9	93.1	86.9	80.1	77.3
% Change	-14.2	10.9	-16.3	-1.0	1.3	-12.2	-12.0	-2.4	-23.4	-6.6	-7.9	-3.5
5+ Family Units	531.7	456.3	440.9	412.3	401.0	400.6	387.8	402.6	575.8	555.3	413.7	399.0
% Change	-3.3	-26.4	-31.5	-30.1	-24.6	-12.2	-12.0	-2.4	6.2	-3.5	-25.5	-3.5
Mobile Homes Shipped	237	244	253	257	271	280	290	301	283	249	265	301
New Single Family Home Sales (1000's)	686	709	686	676	669	654	645	632	689	745	671	665
Percent Change -- Year Ago	-4.5	0.3	-13.1	-14.9	-2.5	-7.8	-6.0	-6.5	8.2	8.1	-9.9	-0.9
New Home Prices -- Median ($1000)	92.3	95.5	93.9	94.6	95.2	95.8	96.3	97.1	84.3	92.0	94.9	97.7
Percent Change -- Year Ago	10.7	10.0	6.3	2.9	3.1	0.3	2.6	2.6	5.4	9.1	3.2	3.0
New Home Prices -- Average ($1000)	101.2	97.8	101.4	103.6	104.4	101.0	105.1	107.4	95.6	99.3	102.6	106.5
Percent Change -- Year Ago	6.4	0.7	4.3	2.8	3.2	3.3	3.6	3.7	2.0	3.9	3.3	3.8
NAR Affordability Index	103.8	109.4	110.3	110.9	113.6	114.8	117.7	115.4	94.8	105.7	112.4	121.5
Mortgage Debt Outstanding ($ billions)	2422	2537	2574	2636	2700	2766	2831	2897	2202	2413	2669	2930
Housing Inventory (millions)	97.3	97.7	98.1	98.6	99.0	99.4	99.8	100.2	95.2	97.0	98.8	100.4
Rental Vacancy Rate (%)	7.5	7.7	7.4	7.1	6.9	9.7	6.5	6.4	6.5	7.4	7.0	6.3
FINANCIAL MARKETS												
Money Supply (M1)(% change)	17.5	18.1	14.0	7.6	7.5	6.2	6.6	6.0	9.1	13.3	12.7	6.5
Velocity of M1 (% change)	-9.5	-13.8	-7.4	-2.2	-1.9	-0.4	-0.3	-0.4	-2.6	-7.1	-7.2	-0.9
Value of the U.S. Dollar (Trade-Weighted)	108.3	107.0	99.6	98.2	97.0	95.9	95.1	94.3	143.2	112.3	97.7	93.8
Percent Change	-19.1	-4.8	-25.0	-5.3	-4.8	-4.6	-3.4	-3.2	3.5	-21.6	-13.0	-4.0
Flow of Funds (NIA Basis) (Billions of dollars, saar)												
Sources:(total:gross savings)												
Private Saving	650.5	640.8	658.3	652.2	645.0	663.0	691.5	694.3	687.6	678.1	654.6	696.8
Personal Saving	84.1	73.5	107.6	95.7	81.0	89.0	104.5	102.2	143.3	114.1	93.3	104.1
Savings Rate	2.8	2.5	3.5	3.1	2.6	2.8	3.3	3.1	5.1	3.8	3.0	3.2
Gross Business Savings	566.4	567.3	550.7	556.5	564.0	574.0	587.0	592.1	544.3	564.0	561.3	592.7
Federal Deficit	-197.4	-195.9	-177.8	-168.0	-170.0	-177.7	-180.0	-176.3	-198.0	-205.1	-173.4	-182.3
State & Local	64.0	59.4	58.3	60.4	60.9	61.4	62.9	66.1	61.7	63.0	60.2	64.9
Net Foreign Investment	-148.4	-150.6	-149.9	-154.4	-161.3	-164.2	-157.1	-160.5	-115.2	-142.6	-157.4	-160.4
Uses (total:gross investment)	675.8	665.3	699.2	703.7	699.4	707.9	733.5	744.1	661.2	684.2	702.6	740.5
Nonresidential Investment	454.4	455.9	451.8	452.5	455.0	456.6	460.7	464.2	461.4	456.2	454.0	464.3
Structures	129.5	127.1	126.7	127.3	128.0	128.2	129.1	130.0	152.2	134.4	127.5	129.9
Equipment	324.9	328.8	325.1	325.2	327.0	328.4	331.6	334.1	309.3	321.8	326.4	334.4
Residential Investment	197.2	200.2	201.0	199.2	197.4	197.8	198.0	198.6	177.3	194.1	198.9	197.6
Inventory Investment ($ billions)	-0.3	-24.4	9.7	9.5	-0.3	0.1	15.2	15.5	9.0	7.6	4.7	10.1
Selected Interest Rates (%)												
Mortgage Rates												
30-year Fixed Rate Mortgage<1>	9.9	9.4	9.1	8.9	8.8	8.7	8.7	8.8	12.2	9.9	8.9	8.9
1-year ARM (without buydown)	7.3	7.2	6.8	6.7	6.5	6.3	6.3	6.4	10.0	7.9	6.6	6.5
Corporate AAA Bond Rate	8.8	8.7	8.4	8.2	8.1	8.0	7.9	8.0	11.4	9.0	8.2	8.1
Government Bond Rate	7.4	7.5	7.4	7.2	7.0	6.8	6.7	6.9	10.8	7.8	7.1	6.9
Federal Funds Rate	6.2	6.3	6.2	5.9	5.6	5.6	5.7	5.9	8.1	6.8	5.8	5.9
3-month T-Bill Rate	5.5	5.3	5.5	5.1	5.1	5.0	5.0	5.1	7.5	6.0	5.2	5.2
Prime Rate	7.9	7.5	7.5	7.5	7.2	7.2	7.4	7.5	9.9	8.3	7.4	7.5
Discount Rate	5.8	5.5	5.5	5.5	5.2	5.2	5.4	5.5	7.7	6.3	5.4	5.5

<1> FHA Secondary Mortgage Market Rate.

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
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Forecasting & Policy
Analysis Division
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The Outlook for the Economy and Real Estate

GNP-Growth - Mostly Inventory Building

The latest estimate of the real GNP growth rate (4.3 percent) seems to suggest another step forward in the current economic expansion. However, a more accurate assessment would be that the economy is "muddling through" the late years of a 4 year old expansion. Most of the growth increase was due to higher levels of U.S. manufacturing production; certainly a good sign. Countering this good news was the fact that most of this production ended up as inventory because consumer demand for these items had fallen off the past two quarters. Besides this recent spate of inventory building, real net exports was the only other major component in the U.S. economy to contribute positively to GNP growth. The other sectors of the economy -- business fixed investment, consumption, residential construction, and government purchases -- declined during the first quarter. This is an important signal because these core sectors are the real "guts" behind any sustained expansion. In the current quarter, the growth rate of real GNP should slow to 1.2 percent because weak inventory investment will offset the consumption rebound, and real net exports will lose some steam because of an expected rise in oil imports. For all of 1987, the rate of growth in real GNP will likely be about 2.3 percent, followed by a similar 2.5 percent growth rate in 1988, as the mature expansion struggles to recover some of its lost vigor.

Consumption is expected to rebound for much of the same reason that it declined in the last two quarters — auto sales. Sales of automobiles surged in the third quarter of 1986 in response to a large sales incentives package. They continued at a robust pace in the fourth quarter because consumers moved up 1987 purchases into 1986 to take advantage of the doomed sales tax deduction. The "payback" for these advance purchases hit in the first quarter of 1987, and auto sales could resume at a healthy pace for the remainder of 1987, with some additional production perhaps devoted to building an inventory buffer in case of an auto workers strike.

Investment spending by businesses for structures dropped 21.0 percent in the first quarter, and equipment spending was off almost 10 percent from its fourth quarter level. Equipment spending has already suffered throughout 1986 because of the retroactive elimination of the investment tax credit by the new tax reform law, so 1987 should see new life in equipment spending. Investment spending on structures was also hit hard by the new tax law, but the recovery will not be as quick as that of equipment spending because high vacancy rates will hold back investment in new structures over the next couple years.

A New Import - Inflation?

It is very hard to reconcile the current weak state of the economy -- weak demand in the key sectors of consumption and business fixed investment -- with a new round of high inflation. Typically, high inflation rates are the result of an overheating economy in which wages and prices chase each other in a crippling upward spiral. This time around, higher inflation will likely enter the economy via higher import prices due to the weaker U.S. dollar. U.S. producers will then be able to raise their prices along with foreign importers, leading to a somewhat higher level of inflation during 1987. But without strong consumption and investment spending, wages will likely only rack up modest gains and consumer price inflaton will rise to only about 3.7 percent in 1987, up from 1.9 percent in 1986 and 3.0 percent in our March-April forecast. If the dollar decline continues modestly through 1988, helping to adjust the trade balance, inflation could rise to 4.2 percent in 1988, before falling below 4.0 percent in 1989.

What Will the Fed Do?

Whether these developments and emerging trends are actually borne out over the forecast interval will be determined in large part by the conduct of monetary policy. Federal Reserve Chairman Volcker has devoted his two terms to stamping out inflation while allowing reasonable economic growth. Odds are that he is not about to abandon his concern for inflation. Yet, the latest round of dollar depreciation in currency markets has caused increasing hesitancy among foreign investors who are considering purchasing and/or holding dollar-denominated assets. They fear that as the dollar falls in value, so will the value of their dollar-denominated investments. Interest-sensitive sectors of the U.S. economy, particularly the housing industry, have come to depend on net foreign capital inflows to finance investment and keep domestic interest rates lower than what they otherwise would be.

The Fed has responded to this crisis by allowing short term interest rates to rise in order to help stabilize the value of the dollar on world markets and to calm inflation fears. But despite the Fed's efforts at stabilizing the dollar, foreign investors' skepticism remains and has led them to demand higher yields on long-term U.S. investments. This has abruptly reversed the rally in the U.S. bond market and sent U.S. long term interest rates skyrocketing. The initial panic seems to have subsided, but long term rates remain very high relative to their levels of late March.

The hope is that this recent rise in long term rates represents more of an increase in inflationary expectations by investors and not actually a rise in the real interest rate (nominal interest rate minus inflation). An increase in real interest rates at this time of weak domestic demand could push the U.S. economy into a recessionary period of negative GNP growth rates. Instead, this forecast assumes that at least half of the long term rate rise was due to inflationary expectations, and that these expectations will erode back to previous levels producing a downward trend in long-term interest rates over the coming quarters.

Housing Markets

Existing Homes

The first quarter of 1987 ended on a very positive note for the real estate industry, as sales of existing single-family homes rose to an annual rate of 3.71 million units in March. This rate was a 0.5 percent increase over the February sales pace of 3.69 million units, and a 14.5 percent rise above the March 1986 sales rate. However, the prospects for the second quarter of 1987 are not quite as good, owing to the recent surge in long term interest rates. These rates are expected to trend downward throughout 1987, meaning that existing homes will still be sold at a robust pace of 3.49 million units, only slightly off from the 1986 sales rate of 3.56 million units. In 1988, sales of existing homes will be gaining momentum steadily and could post a sales rate of 3.68 million units for the year.

Housing Starts

Starts of single-family homes set a strong pace in the first quarter with an average annual rate of 1.27 million units--a rise of 3.3 percent over the first quarter of 1986, and stronger than any quarter in 1986. However, despite the strength of the single-family numbers, total housing starts fell to 1.77 million units in March, down from 1.89 million units in March 1986. The average annual rate

for total housing starts in the first quarter was 1.81 million units, down 6.7 percent from the 1.94 million unit rate of the first quarter of 1986. Total starts were pulled down by continued weakness in multi-family units. The first quarter average annual rate of 542 thousand units was virtually unchanged from the fourth quarter rate of 543 thousand units, and was 23.8 percent below the 711 thousand unit rate of the first quarter in 1986. Total housing starts are expected to decline to 1.66 million units in the current quarter because of the interest rate surge. The expected downward trend in long-term interest rates will touch off modest gains in housing starts, bringing total starts to a level of 1.68 million units for 1987, and 1.71 million units in 1988. Both single-family and multi-family starts will suffer from the rate rise, but single-family starts will rebound quickly to 1.21 million units in 1987, and 1.24 million units in 1988. Multi-family units will remain depressed because of the adverse impacts of the new tax law, reaching only 471 thousand units in 1987, and 477 thousand units in 1988.

Risks to the Forecast

Exactly how much inflation should be expected in 1987 is a subject of much debate because of the greenback's recent gyrations. Our forecast calls for a somewhat higher rate of inflation this year than last, but it is possible that prices could rise by as much as 5.0 percent this year. It should be stressed that we feel this is an unlikely scenario because the economy is fundamentally weak. But, if higher inflation were to materialize, it would probably come as a result of further sharp declines in the dollar that would lead to even higher import prices than in the present forecast, and touch off still higher expectations of inflation. What this means for the real estate industry is that faster inflation than assumed in this forecast would probably postpone the expected return of long term interest rates to their lower levels of earlier this year.

U.S. ECONOMIC OUTLOOK

	QUARTERS							YEARS				
	Actual		Forecast					Actual		Forecast		
	1986.4	1987.1	1987.2	1987.3	1987.4	1988.1	1988.2	1988.3	1985	1986	1987	1988	1989
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4,259	4,339	4,390	4,443	4,515	4,584	4,656	4,726	3,998	4,206	4,422	4,693	4,994
% Change	1.7	7.8	4.8	4.9	6.7	6.2	6.5	6.2	6.2	5.2	5.1	6.1	6.4
% Change (w/out inflation)	1.1	4.3	1.2	1.4	3.2	2.2	2.8	2.7	2.7	2.5	2.3	2.5	2.8
Consumer Prices (CPI)	2.9	5.3	4.5	4.4	4.3	4.3	4.2	3.8	3.5	1.9	3.7	4.2	3.6
GNP Deflator	0.7	3.5	3.4	3.4	3.4	3.9	3.6	3.4	3.3	2.6	2.8	3.6	3.5
Unemployment Rate (%) (civilian)	6.8	6.7	6.7	6.8	6.8	6.9	6.8	6.8	7.2	7.0	6.7	6.8	6.6
Civilian Employment - Household Basis (millions)	110.4	111.3	111.6	112.0	112.4	112.7	113.1	113.5	107.2	109.6	111.8	113.3	114.9
% Change	1.6	3.3	1.1	1.4	1.4	1.1	1.4	1.4	2.0	2.3	2.0	1.3	1.4
Mfg. Capacity Utilization	79.8	79.9	79.3	78.8	79.0	79.0	79.2	79.4	80.3	79.7	79.2	79.3	80.0
Domestic Auto Sales	7.9	6.8	7.2	7.8	7.1	7.4	7.5	7.5	8.2	8.4	7.2	7.5	7.7
Federal Tax Receipts (NIPA)	855	854	879	891	912	910	928	945	787	827	884	937	997
% of GNP	20.1	19.7	20.0	20.1	20.2	19.8	19.9	20.0	19.7	19.7	20.0	20.0	20.0
Federal Expenditures (NIPA)	1,043	1,050	1,050	1,060	1,079	1,090	1,103	1,120	985	1,030	1,060	1,113	1,166
% of GNP	24.5	24.2	23.9	23.9	23.9	23.8	23.7	23.7	24.6	24.5	24.0	23.7	23.3
Deficit (NIPA)	-188.8	-196.0	-171.8	-169.3	-167.8	-180.7	-175.6	-175.2	-198.0	-203.4	-176.2	-176.6	-168.4
% of GNP	-4.4	-4.5	-3.9	-3.8	-3.7	-3.9	-3.8	-3.7	-4.9	-4.8	-4.0	-3.8	-3.4
REAL ESTATE MARKETS													
Total Single-Family Home Sales (single-family resales and completions, 1000)	4,855	4,851	4,502	4,589	4,700	4,730	4,876	4,905	4,255	4,717	4,660	4,883	5,062
Percent Change -- Year Ago	6.9	8.6	-3.6	-3.0	-3.2	-2.5	8.3	6.9	8.2	10.9	-1.2	4.8	3.7
Existing Single-Family Home Sales (1000)	3,890	3,623	3,356	3,447	3,532	3,578	3,677	3,705	3214	3565	3490	3684	3892
Percent Change -- Year Ago	6.6	10.2	-3.3	-4.8	-5.3	-1.2	9.6	7.5	12.1	10.9	-2.1	5.6	5.6
Housing Starts	1,702	1,808	1,663	1,604	1,638	1,628	1,707	1,723	1,742	1,819	1,678	1,713	1,750
% Change	-5.3	-6.7	-11.5	-8.8	-3.8	-10	2.6	7.4	-1.4	4.4	-7.8	2.1	2.2
Single-Family Units	1,159	1,266	1,181	1,177	1,204	1,188	1,236	1,237	1,073	1,188	1,207	1,236	1,206
% Change	5.6	3.2	-2.9	2.4	3.9	-6.1	4.6	5.1	-2.4	10.8	1.6	2.4	-2.5
Multi-Family Units	543.7	542.0	481.2	426.3	433.9	439.1	470.6	485.8	669.7	631.2	470.9	477.1	544.8
2-4 Family Units	88.0	78.3	77.9	69.0	70.3	71.1	76.2	78.6	93.4	85.4	73.9	77.2	88.2
% Change	7.8	-18.4	-3.8	-10.0	-20.2	-9.3	2.2	14.0	-23.3	-8.6	-13.5	4.5	14.2
5+ Family Units	455.7	463.7	403.3	357.3	363.7	368.0	394.4	407.1	576.2	545.8	397.0	399.8	456.6
% Change	-26.3	-24.6	-30.5	-32.8	-20.2	-20.6	-2.2	14.0	5.5	-5.3	-27.3	0.7	14.2
New Single-Family Home Sales (1000)	711	711	653	667	684	674	691	705	688	749	679	699	725
Percent Change -- Year Ago	-5.3	-9.9	-9.9	-2.8	-3.8	-5.2	5.8	5.7	7.7	8.9	-9.4	2.9	3.8
Mobile Homes Shipped (1000)	243	233	252	254	260	260	268	270	283	249	250	269	316
New Home Prices -- Median ($1000)	95.0	95.9	94.9	95.2	95.6	96.6	97.6	98.5	84.3	92.2	95.4	97.8	101.5
Percent Change -- Year Ago	10.0	9.0	3.6	3.1	0.6	0.3	2.1	2.7	5.4	9.4	3.5	2.5	3.8
New Home Prices -- ($1000, Quality Adj. to 1982)	93.6	97.1	97.3	98.4	98.8	99.5	100.9	102.3	92.4	94.9	97.9	101.2	104.7
Percent Change -- Year Ago	0.6	3.9	0.9	2.5	5.5				2.8	2.7	3.2	3.4	3.5
Existing Home Prices - Median ($1000)	79.4	83.9	82.2	83.1	84.2	84.9	86.0	86.5	75.5	80.3	83.4	86.2	89.8
Percent Change -- Year Ago	5.6	4.3	0.2	3.6	6.0	1.2	4.6	4.1	4.4	6.4	3.8	3.4	4.2
Mortgage Payment	529	530	592	579	566	566	554	562	631	559	566	560	557
Housing Affordability Index	109.3	110.7	101.5	105.5	108.5	109.9	116.2	116.1	94.8	105.7	106.6	114.1	115.3
Dollar Volume (billions)	364	372	338	350	363	369	383	389	291	355	356	386	424
FINANCIAL MARKETS													
Long-Term Interest Rates (%)													
30-year Fixed Rate Mortgage	9.4	8.8	10.3	9.9	9.5	9.4	9.0	9.1	12.2	9.9	9.6	9.1	8.6
1-year ARM (without buydown)	8.3	8.1	7.8	7.7	7.5	7.5	7.2	7.4	10.1	8.4	7.8	7.4	7.2
Corporate AAA Bond Rate	8.7	8.4	9.4	9.0	8.7	8.6	8.2	8.2	11.4	9.0	8.9	8.3	7.8
Government Bond Rate	7.5	7.5	8.6	8.2	7.9	7.6	7.4	7.3	10.8	7.8	8.1	7.4	7.2
Short-Term Interest Rates (%)													
Federal Funds Rate	6.3	6.2	6.3	6.3	6.3	6.4	6.5	6.7	8.1	6.8	6.3	6.6	7.1
3-month T-Bill Rate	5.4	5.5	5.7	5.5	5.5	5.4	5.5	5.7	7.5	6.0	5.6	5.6	6.0
Prime Rate	7.5	7.5	7.9	8.0	8.0	8.2	8.2	8.2	9.9	8.3	7.8	8.2	8.4
Discount Rate	5.5	5.5	5.5	5.5	5.6	5.8	5.9	5.9	7.7	6.3	5.5	5.9	6.2
Money Supply (M1)(% change)	18.2	13.6	5.5	6.7	6.1	6.8	6.8	7.1	9.1	13.3	12.1	6.6	6.2
Value of the U.S. Dollar (Trade-Weighted Avg.)	107.0	99.9	96.3	94.7	93.9	93.3	93.0	92.9	143.2	112.3	96.2	93.0	92.4
% Change	-4.8	-24.2	-13.5	-6.4	-3.5	-2.5	-1.3	-0.4	3.5	-21.6	-14.3	-3.3	-0.7

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr. Frederick Flick and Sean Burns.

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Outlook for the Economy and Real Estate

Forecasting & Policy
Analysis Division
NATIONAL ASSOCIATION OF REALTORS®
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Changing of the Guard:
Economic Commentary

by

John A. Tuccillo
Chief Economist and
Senior Vice President
Real Estate Finance

As most economists do sometime in their careers, I was caught in one of those unfortunate predictions last month. For most of the first half of this year, I was forecasting that the major economic event of 1987 would be the naming of the Federal Reserve Chairman (true), and that if Paul Volcker were not reappointed economic disaster would soon follow (false). Well, Alan Greenspan has been appointed, and the sun (and the Dow) continues to rise each day. It's probably appropriate to take a little more thorough look at what actually has changed, where Mr. Greenspan will take the Fed, and what that implies for the economy and for real estate.

To begin with, no Fed Chairman is fully independent. The importance which the markets put not only on his words but also the phrasing and intonation of those words will inevitably force the Chair to speak very carefully and conservatively. Moreover, the opinions allowed to an outside consultant who can pack up and move on to the next client are not allowed to the head of the world's most central bank. Finally, the current Board is heavily oriented to a supply-side view of the world, and their opinions will be felt in all policy dicussions. All this suggests that Mr. Greenspan's past is not an infallible guide to his future.

With the caveat, several suppositions can be made about the direction of the Greenspan Fed:

1. Fighting inflation will remain a high priority. Those who suggest that Greenspan will tilt more toward growth than did Volcker ignore his history. When at the Council of Economic Advisors in the Ford Administration, Greenspan espoused strong anti-inflation policies even when such were not popular. While the ill-fated "WIN" campaign was the result of these, nevertheless, Greenspan has shown by deeds the depth of his commitment to fighting inflation.

2. The budget deficit will be an object of attack. Much more so than Mr. Volcker, Alan Greenspan has spoken against the deficit. It is likely that the Fed will line up even more firmly in the anti-deficit camp than it has. The unfortunate part of this is that it is unclear where Mr. Greenspan can apply this pressure for it to have any effect.

3. The Fed will shift to the side of deregulation. Under Volcker, the Fed was firmly against the expansion of financial powers, arguing that such expansion was inappropriate and dangerous. Mr. Greenspan has long been an outspoken supporter of an unregulated financial market, one in which full powers are available to all types of institutions. While this view cannot be as strongly held at the Fed, look for a clear movement away from the Volcker position.

What does all this mean for the economy and housing? Fortunately, Greenspan's appointment warranted only a slight hiccup in financial markets. The dollar has firmed up and the trade balance is clearly improved. This suggests that we will see a pause in growth as the manufacturing sector, stimulated by a more clement international climate, accelerates and takes the lead in the expansion from the flagging consumption sector. That means Mr. Greenspan will not likely be called on in the first several months of his term to make any major policy moves. What we can expect is a slow repositioning of the Fed to reflect his priorities and those of his fellow board members.

For housing, we're looking at "more of the same." Demand will remain strong, and in the face of stable interest rates, so will housing starts and sales. This is a most extraordinary year, not because it will set records, but rather because in the fifth year of a housing expansion, the market still has a great deal of steam.

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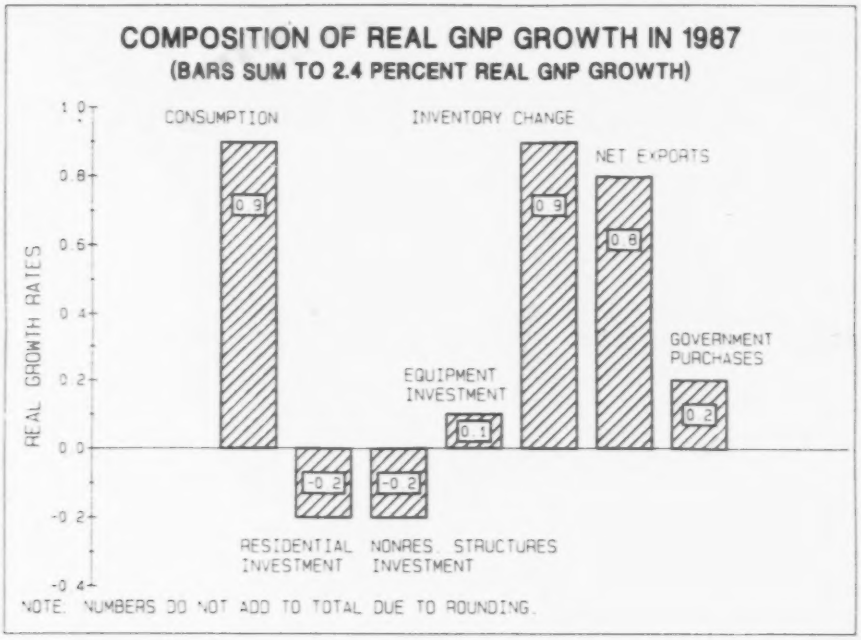
The Outlook for the Economy and Real Estate

Economic growth in the second quarter will not come close to the 4.8 percent annual growth rate of the first three months, but this does not imply that the economy is fundamentally different from the first quarter. "Muddling through" remains the catch phrase as overbuilding of inventories, the biggest source of first quarter growth, will force businesses to hold back on this investment in the current quarter. Net exports also contributed strongly to real GNP growth in the first quarter, and will probably do so again in the second quarter. The second half of the year could see less growth in net exports if the current forecast of a firmer dollar (145 to 150 yen) is played out. Normally the dominant source of growth in recent years, big-spending consumers have been conspicuous by their absence in late 1986 and early 1987. This was partly due to buying to beat tax reform, and the large incentives offered by automakers last fall. Renewed strength in consumption is expected to supply the bulk of economic growth in the remainder of 1987, helping the economy to reach the 2.4 percent real GNP growth forecast.

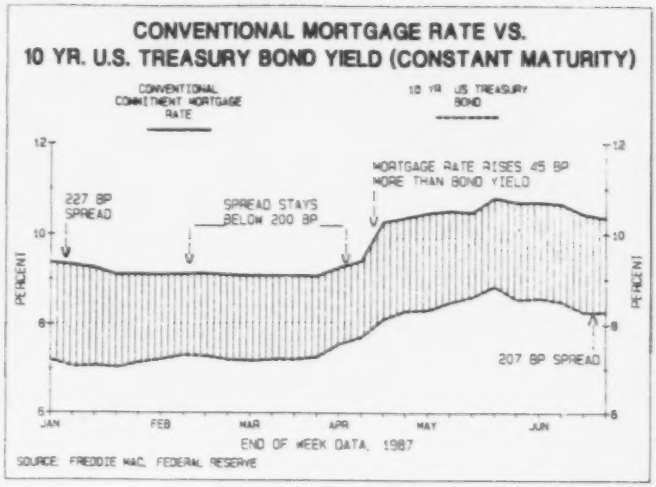
The chart below presents a snapshot of how the economy is expected to look in 1987. Sectors that are expected to contribute positively to real GNP growth throughout the year are consumption, inventory investment and net exports.



The silver lining of this slow growth forecast is that it whittles away expectations of higher inflation that had fueled a run-up in long term interest rates since late March. That rise in long term rates, which sent the bond market into a tail spin, occurred partly because government reports indicated higher inflation and there was a great deal of uncertainty over the direction of the dollar and the conduct of monetary policy. Since then, inflation-fearing investors have been calmed by sluggish economic indicators, and by a dollar made firmer on the news of real and nominal improvements in trade flows. Also, U.S. interest rates remain 5 to 6 percent above rates on comparable investments in Japan and West Germany. Therefore, the expectation of a firmer dollar reduces the likelihood of immediately higher inflation through increases in import prices in the second half of 1987. The only other route into the economy for inflation to follow is a new wage-price spiral. The fact is, final demand in the U.S. is just not hot enough to ignite such a spiral. The consumer price inflation forecast remains moderate at 4.0 percent in 1987, and 4.1 percent in 1988.

In light of this moderate inflation/firmer dollar forecast, Mr. Greenspan might have a little room to boost money supply growth in late 1987 and early next year. This is not in agreement with the political pundits who wager that in an election year Mr. Greenspan will be more attuned to White House communiques on the economy than was Mr. Volcker. It seems likely that Mr. Greenspan's knowledge and credibility within the financial community will afford him relative independence from election year politics.

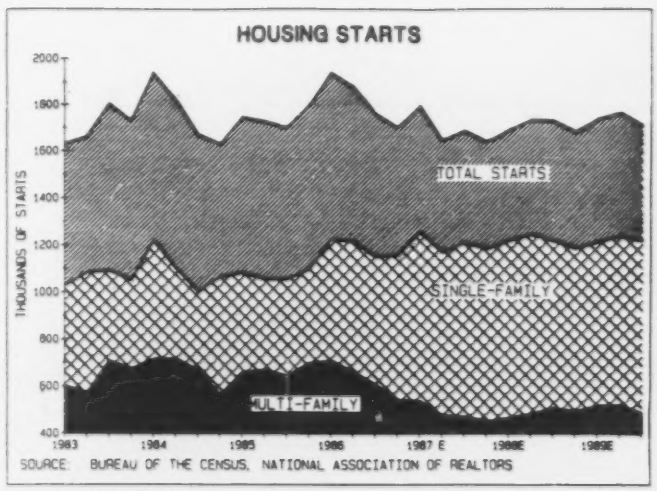
Still, if the dollar continues to trade at 145 yen or higher and inflation remains under control, then the Fed might consider a bit faster money growth. This is the assumption of the current forecast, which would lead to some softening in short term rates. Concurrently, a modest bond market rally is expected which would help pull long term mortgage rates down to 9.4 percent by the fourth quarter, and to 9.1 percent in 1988. The chart shows the historical relationship between the conventional commitment mortgage rate and the yield on U.S. Treasury bonds. As expected, the mortgage rate is very responsive to upward movements in Treasury bond yields, but is somewhat slower to follow the Treasury bond to lower levels. Currently, mortgage rates are slowly trending downward in response to lower bond yields.



Real Estate Markets

Housing Starts

Housing starts have now fallen for three consecutive months because of higher mortgage interest rates and continued weakness in multi-family starts. In May, housing starts fell to 1.62 million units from 1.665 million units in April and 1.730 million units in March. Single-family units were started at a seasonally adjusted annual rate of 1.129 million units, 7.6 percent below the April rate of 1.222 million units. Single-family starts are expected to rise back above 1.2 million units in the third quarter before trailing off in the final quarter for a 1987 total of 1.206 million units. Both 1988 and 1989 appear to be better years for housing starts activity because of lower mortgage interest rates.



Multi-family units were started at a rate of 416 thousand units in May, compared to 378 thousand units in April. This was the first monthly rise in multi-family starts since January 1987. This could be the beginnings of a gradual recovery in multi-family starts after they declined in response to the latest tax reform bill and high vacancy rates. Multi-family units are expected to be started at a rate of 486 thousand units in 1987 and 490 thousand units in 1988.

Existing Home Sales

Sales of existing single-family homes continued at a very strong annual rate of 3.74 million units in May, up 5.1 percent from April and 8.1 percent above the May 1986 rate. It appears that many homebuyers were able to hold on to the low commitment rates of late March, giving the appearance that existing home sales were not affected by the interest rate surge. Resales appeared to gain some strength in the South and West regions, perhaps because investors believe home prices in the oil-producing states have reached bottom and will soon begin to rise.

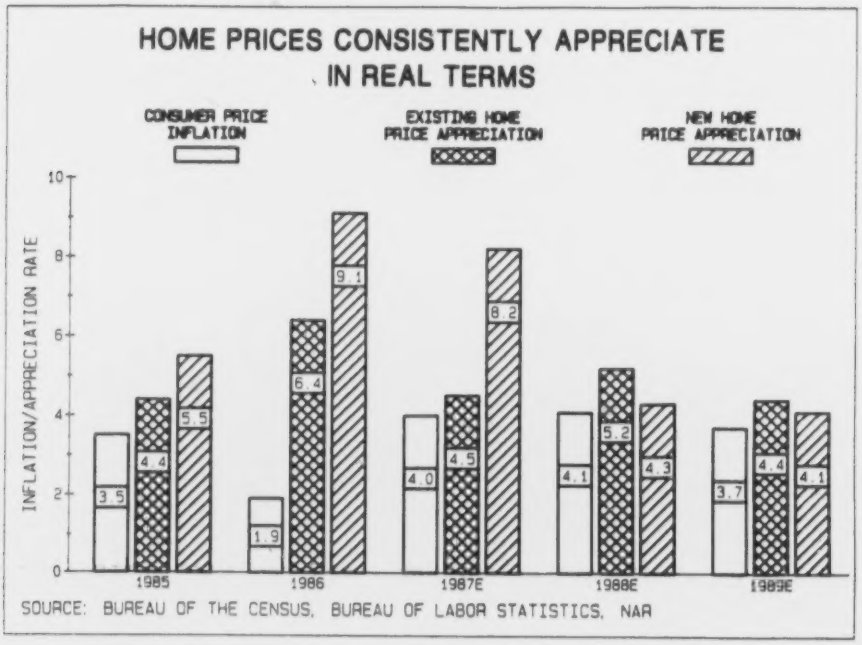
But an adjustment to the interest rate rise is certainly in store. We expect this adjustment to take place mostly in the third quarter as existing homes are sold at the slightly lower rate of 3.41 million units. Much lower home sales rates are not likely given the present stability in mortgage rates and the much higher prices on new homes for sale (see below). Existing home sales should then increase to 3.44 million units in the fourth quarter for a 1987 total of 3.51 million units. Both 1988 and 1989 are expected to be stronger years for existing home sales with activity forecast in the 3.6 to 3.7 million unit range.

New Home Sales

New home sales were affected quickly and substantially by the surge in mortgage rates. In May, new single-family homes were sold at an annual rate of 616 thousand units, almost 21 percent below the May 1986 rate and a 14.9 percent retreat from the April 1987 rate of 724 thousand units. The April rate was itself revised down from a preliminary rate of 777 thousand units. This large drop in May new home sales was accompanied by a report that the median new home price had jumped over 9 percent. This does not mean that new homes are in strong demand, but rather that those buyers able to afford a new home after the mortgage rate rise were wealthier individuals who tended to purchase more expensive homes. Therefore, the 1987 forecast of 680 thousand new home sales is more indicative of the strength of the first quarter (a rate of 711 thousand units), than more robust activity later this year. The slow decline in mortgage rates forecast through 1988 should be enough to boost new home sales to 723 thousand units in that year.

Existing and New Home Prices

Both existing and new home prices should appreciate in real terms (faster than inflation) over the forecast horizon. In 1987, new home prices will probably appreciate faster than those of existing homes, but not because new homes are in greater demand. As explained above, the interest rate surge forced many new home shoppers to consider purchasing an existing home because the lower prices presented a better value. Those left in the new home market tended to be more willing to pay the higher price for a new home. While the more affordable existing home market will likely experience less home price appreciation this year, existing home prices will still appreciate in real terms. This slower price appreciation is helping homebuyers adjust to the interest rate surge and will help maintain demand for existing homes over the forecast interval. In 1988 and 1989, new home prices will probably rise at slower rates because builders will be trying to revive market demand.



U.S. ECONOMIC OUTLOOK

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AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4,259	4,352	4,402	4,466	4,534	4,603	4,661	4,729	3,998	4,206	4,439	4,699	4,993
% Change	1.7	9.1	4.7	5.9	6.2	6.2	5.1	5.9	6.2	5.2	5.5	5.9	6.3
% Change (w/out inflation)	1.1	4.8	0.8	2.3	2.6	2.0	2.2	2.8	2.7	2.5	2.4	2.3	2.8
Consumer Prices (CPI)	2.9	5.3	4.9	4.4	4.3	4.6	4.1	4.1	3.5	1.9	4.0	4.1	3.7
GNP Deflator	0.7	4.2	3.7	3.6	3.5	4.1	2.9	3.1	3.3	2.6	3.1	3.5	3.4
Unemployment Rate (%) (civilian)	6.8	6.7	6.3	6.3	6.3	6.4	6.4	6.3	7.2	7.0	6.4	6.3	6.1
Civilian Employment - Household Basis (millions)	110.4	111.3	112.1	112.5	112.9	113.3	113.7	114.1	107.2	109.6	112.2	113.9	115.5
% Change	1.6	3.1	3.1	1.4	1.6	1.2	1.5	1.6	2.0	2.3	2.4	1.5	1.5
Manufacturing Capacity Utilization	79.8	79.7	80.2	79.9	79.9	79.8	79.8	80.0	80.3	79.7	80.0	79.9	80.4
Domestic Auto Sales	7.9	6.8	7.1	7.3	7.2	7.2	7.5	7.6	8.2	8.4	7.1	7.5	7.7
Federal Tax Receipts (NIPA)	854.5	872.8	918.3	895.7	909.6	930.6	945.6	950.3	786.9	826.9	899.1	948.9	1011.3
% of GNP	20.1	20.1	20.9	20.1	20.1	20.2	20.3	20.1	19.7	19.7	20.3	20.2	20.3
Federal Expenditures (NIPA)	1043.4	1043.3	1048.4	1058.4	1077.9	1085.6	1098.5	1115.0	984.9	1030.3	1057.0	1107.9	1155.3
% of GNP	24.5	24.0	23.8	23.7	23.8	23.6	23.6	23.6	24.6	24.5	23.8	23.6	23.1
Deficit(NIPA)	-188.8	-170.4	-130.1	-162.7	-168.3	-155.1	-152.9	-164.7	-198.0	-203.4	-157.9	-159.0	-144.0
% of GNP	-4.4	-3.9	-3.0	-3.6	-3.7	-3.4	-3.3	-3.5	-4.9	-4.8	-3.6	-3.4	-2.9
REAL ESTATE MARKETS													
HOME SALES													
Total Single-Family Home Sales (1000, single-family resales plus 97 percent of single-family starts)	5,014	4,835	4,715	4,587	4,590	4,686	4,821	4,840	4,254	4,717	4,682	4,793	4,881
Percent change -- year ago	9.9	7.9	1.2	-2.5	-8.5	-3.1	2.2	5.5	8.5	10.9	-0.1	1.8	1.1
Existing Single-Family Home Sales (1000)	3,890	3,617	3,580	3,410	3,440	3,500	3,610	3,656	3,214	3,565	3,512	3,610	3,683
Percent change -- year ago	6.6	9.9	3.0	-4.9	-11.6	-3.2	0.8	7.2	12.1	10.9	-1.5	2.8	2.0
Housing Starts	1702.3	1794.7	1648.0	1685.9	1638.1	1689.9	1734.2	1729.5	1742.3	1819.2	1691.7	1709.7	1735.4
Percent change -- year ago	-5.3	-7.4	-12.3	-4.1	-3.8	-5.8	5.2	2.6	-1.4	4.4	-7.0	1.1	1.5
Single-Family Units	1158.7	1255.7	1169.9	1213.7	1185.2	1222.3	1248.4	1220.5	1072.6	1188.1	1206.1	1220.1	1235.4
Percent change -- year ago	5.6	2.4	-3.9	5.5	2.3	-2.7	6.7	0.6	-2.4	10.8	1.5	1.2	1.3
Multi-Family Units	543.7	539.0	478.0	472.2	452.9	467.6	485.8	509.0	669.7	631.2	485.5	489.6	500.0
2-4 Family Units	88.0	80.0	77.4	76.4	73.3	75.7	78.6	82.4	93.4	85.4	76.8	79.5	81.2
Percent change -- year ago	7.8	-16.7	-4.5	-0.3	-16.7	-5.4	1.6	7.8	-23.3	-8.6	-10.1	3.5	2.1
5+ Family Units	455.7	459.0	400.6	395.7	379.6	391.9	407.1	426.6	576.2	545.8	408.7	410.1	418.8
Percent change -- year ago	-26.3	-25.4	-31.0	-25.6	-16.7	-14.6	1.6	7.8	5.5	-5.3	-25.1	0.3	2.1
New Single-Family Home Sales (1000)	711	711	653	673	684	712	727	737	688	749	680	723	745
Percent change -- year ago	0.6	-9.9	-17.8	-1.9	-3.8	0.1	11.3	9.5	7.7	8.9	-9.2	6.3	3.0
Mobile Homes Shipped (1000)	243	234	249	257	255	257	265	269	283	249	249	267	316
HOME PRICES													
Existing Home Prices - Median ($1000)	80.2	84.2	84.8	82.8	83.6	85.8	87.5	89.1	75.5	80.3	83.9	88.3	92.2
Percent change -- year ago	4.7	7.6	4.7	3.4	2.2	1.9	3.2	7.6	4.4	6.4	4.5	5.2	4.4
New Home Prices - Median ($1000)	95.0	98.6	101.0	99.0	99.6	102.4	103.6	104.8	84.3	92.0	99.5	103.8	108.1
Percent change -- year ago	9.4	11.7	9.9	5.9	4.8	3.9	2.6	5.9	5.5	9.1	8.2	4.3	4.1
Mortgage Payment	535	532	595	562	557	562	578	574	631	559	564	573	588
NAR Affordability Index	109.3	110.3	107.8	104.8	105.4	106.1	106.3	107.4	94.8	105.7	107.1	106.8	107.3
Dollar Volume (billions)	388.4	373.1	375.9	360.2	364.9	376.0	388.8	396.5	291.9	351.1	368.5	389.9	405.1
FINANCIAL MARKETS													
Long-Term Interest Rates (%)													
30-year Fixed Rate Mortgage	9.4	8.8	10.0	9.6	9.4	9.2	9.3	9.0	12.2	9.9	9.5	9.1	8.9
1-year ARM (without buydown)	8.3	8.1	8.0	8.1	8.1	8.0	7.9	7.8	7.6	7.9	8.1	7.9	7.8
Corporate AAA Bond Rate	8.7	8.4	9.2	8.8	8.6	8.4	8.4	8.2	11.4	9.0	8.7	8.3	8.1
Government Bond Rate	7.5	7.5	8.6	8.1	7.9	7.8	7.9	7.6	10.8	7.8	8.0	7.7	7.5
Short-Term Interest Rates (%)													
Federal Funds Rate	6.3	6.2	6.7	6.6	6.5	6.5	6.5	6.8	8.1	6.8	6.5	6.7	7.1
3-month T-Bill Rate	5.4	5.5	5.7	5.7	5.7	5.6	5.6	5.7	7.5	6.0	5.7	5.7	6.0
Prime Rate	7.5	7.5	8.0	8.2	8.2	8.1	8.3	8.3	9.9	8.3	8.0	8.3	8.2
Discount Rate	5.5	5.5	5.5	5.5	5.5	5.4	5.9	5.9	7.7	6.3	5.5	5.8	6.1
Money Supply Growth -- percent change in M1	18.2	13.8	8.4	6.1	5.2	6.3	5.9	7.4	9.1	13.3	12.5	6.3	6.1
Value of the U.S. Dollar (Trade-Weighted Avg.)	107.0	99.9	97.2	99.6	100.6	98.6	96.5	95.0	143.2	112.3	99.3	96.0	93.7
Percent Change	-4.8	-24.2	-10.4	10.6	3.8	-7.7	-8.0	-6.2	3.5	-21.6	-11.5	-3.3	-2.5

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr. Frederick Flick and Sean Burns.

EQUAL HOUSING OPPORTUNITY

9/21/87 A7000-1A

REAL ESTATE OUTLOOK

September/ October 1987

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- **Second quarter GNP grew** at an annual rate of 2.3 percent, revised down from 2.6 percent and barely half the 4.4 percent rate of the first quarter. Composition of second quarter GNP was more indicative of broad-based economic growth than the inventory driven figure of the first quarter.
- **The U.S. trade gap grew** to more than $15 billion in June, and the dollar's early August rally fell apart as a result. However, real net exports again contributed positively to economic growth, exceeding their first quarter level by $5.5 billion.
- **Renewed fears of high inflation** because of the dollar's sudden decline are unlikely to be borne out because of recent reports on inflation. However, foreign investors holding dollar-denominated assets may demand higher real interest rates be paid to them for accepting the exchange rate risk. This potential for higher real rates is the biggest risk factor for this forecast.
- **Existing single-family home sales remain remarkably strong,** in spite of a 175 basis point rise in mortgage rates during the first eight weeks of the second quarter. Both June and July resales were 7 percent above their respective one year ago levels.

IN THIS ISSUE

- Economic Commentary: A NERVOUS SPLENDOR, by John Tuccillo
- Outlook for the Economy and Real Estate
- Statistical Summary Table

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A NERVOUS SPLENDOR:
Economic Commentary

by
John A. Tuccillo
Chief Economist and
Senior Vice President
Real Estate Finance

We've all had those periods, when, despite sunny days and green lights, a feeling of dread creeps into the psyche. It's nearly unconscious, but yet clearly there; surely intangible, but all too palpable. Well, welcome -- not to the Twilight Zone -- but to the American economy of the late Eighties. Despite the ample presence of good news, we can't help but feel that it can not last. How else can one explain the recent success of The Coming Depression of 1990, an exercise that George Bush could justifiably call "voodoo economics?"

Growth continues, and may in fact be accelerating. For the first half of 1987, the economy grew at a real rate of 3.2 percent, and will likely end the year having grown by 3 percent over 1986. In the sixth year of an expansion, that's very healthy. Inflation is up from last year, but still moderate. Prices in 1987 will have grown by about 4.2 percent, with not much sign of acceleration. From these conditions has sprung an unprecedented stock market surge that may ultimately take the Dow above 3,000. Unemployment is down; consumer spending is strong -- I could go on, but you get the picture.

Yet the feeling of dread hangs over the economy. Part of that has been induced by economists striving to be the first to call the recession. After all, reputations are not made by predicting more of the same. Be the first to call the turn, though, and everlasting fame and glory -- not to mention a weekly syndicated column -- can be yours.

But there are real reasons for dread. We suffered a crippling interest rate spike in April and we may well be on the verge of one now. There is a clear possibility that Mr. Greenspan will attempt to establish his inflation-fighter credentials by allowing rates to move upward. The weakness of this expansion has been the savings and investment balance. Higher rates now could close down the expansion by slowing down the growth of productive capacity.

Equally troubling is the way in which the domestic economy is tied to international markets. The April-May spike was set off by fears that the U.S. trade balance was deteriorating and that inflation would accelerate as a result. These fears proved groundless and markets calmed down. But we now lie in a world where the dollar sneezes and the mortgage market catches cold. This would all be fine if the balance of trade for the U.S. were level. In fact, the current imbalance has stubbornly resisted solution, and the dollar sinks even lower. More importantly, we are paying for our profligacy by transferring assets to foreign owners, and the more we need to do this, the more stringent the terms demanded by the transferee. In other words, the U.S. interest rates must rise.

So, pessimism about the economy has its place. All this need not occur, of course. The trade balance has improved in real terms and will respond in dollar terms when foreign producers find they cannot continually lower their goods prices to compensate for their higher-priced currency. If that occurs, the dollar will stabilize as will interest rates. Moreover, the third quarter statistics coming out in October may show weaker growth and persuade the Fed that monetary restraint is not an appropriate policy.

If all these things come to pass, the expansion will roll on at about the same pace, through 1988. The demographic and productivity fundamentals are good enough to maintain the status quo absent negative financial news.

The potential for an end to the expansion is clearly there. Yet it's too early to classify it as a certainty, although we have revised our interest rate forecast upward (see forecast description and special analysis "Risks to the Forecast" below). But despite the splendor and longevity of this expansion, there are some storm clouds on the horizon that bear very close watching.

OUTLOOK FOR THE ECONOMY AND REAL ESTATE

THE ECONOMY

The First Half of 1987

The broadest measure of economic activity, the GNP, grew at a 2.3 percent annual rate of growth in the second quarter, revised down from the preliminary 2.6 percent reported in July. This is scarcely half the 4.4 percent pace at which the economy grew in the first quarter, but while the recession watchers may still have their day, economic growth is expected to push onward at a modest pace over the forecast horizon.

The important difference between the second quarter figure and that of the first period is not so much magnitude as it is content. The second quarter GNP report listed consumption, business fixed investment and net exports as positive contributors, fighting to overcome the negative pull of reduced inventory investment. In addition, real federal purchases surged forward in the quarter due partly to the slower rate of price appreciation for those goods. The net result was a positive, though modest, GNP growth rate due to increases in final sales (GNP activity other than inventory investment). In contrast, the first quarter numbers told virtually the opposite story. Inventory investment combined with only one final sales component, net exports, to produce an attention-grabbing 4.4 percent growth rate; despite a decline in overall final sales.

Dynamics to Watch For in the Second Half

Although the second quarter figure paints a picture of more broad-based economic growth, there are several potentially troublesome developments to be on the lookout for in the remainder of 1987. First, the overall growth rate of real GNP is just enough to keep the economy moving forward, but far from what is needed for a renewed economic expansion. Despite being broad-based, second quarter growth relied heavily upon consumer spending. Residential investment is suffering from the higher interest rates, and could become particularly weak if the rate rise is due to higher real rates (see "Risks to the Forecast" section). Business fixed investment in structures remains very weak, but equipment spending has more than compensated for the shortfall. Government spending through the Commodity Credit Corporation (CCC) program will be a positive factor again in the fourth quarter. In sum, the hot spots in the economy are few, so the 2.5 percent growth projected for the second half depends on consumption spending and real net export growth in the third quarter, and equipment spending and inventory investment in the fourth.

Second, the $15 billion trade deficit reported for June was much higher than earlier monthly reports had led analysts to expect. Real net exports are still improving -- second quarter net exports improved $5.5 billion over the first quarter -- but a worsening of the nominal trade deficit could be a strong catalyst for harsh protectionist legislation. Economists are still searching for reasons why the trade imbalance has proven to be so stubborn. Tired after offering one traditional economic theory after another as explanations for the persistence of the trade deficit, economists now feel that the decline of the dollar alone may not be enough. These economists reason that the trade deficit itself means that the U.S. economy is spending more on purchases of imports than it is earning on sales of exports. They surmise that the complexities of our trade morass boil down to the timeless corollary: "If your outgo exceeds your income, then your upkeep will be your downfall." To repair the damage of this trend will take many years, but the first step, they argue, is to eliminate the federal budget deficit. By so doing, we will be removing a $180 - $200 billion dollar annual economic stimulus package that, through the multiplier effect, pushes present incomes (and expenditures) far beyond their actual level.

Third, these poor trade statistics have touched off another crisis of confidence among investors holding dollar-denominated assets. The dollar is slipping quickly back to the 140 yen/dollar range which could spark fears of renewed inflation. Central banks around the world have been reluctant to stem the dollar's slide. Outside the Fed, U.S. Government officials are being careful not to call for a stronger dollar, fearing tougher trade legislation from Congress might result.

Fourth, the possibility of an auto worker strike against either GM, Ford or both is being discussed as if it were already under way. GM fired off an incentive program that is likely to deplete auto inventories by the time a strike would likely begin. The move is viewed as a sign of confidence on GM's part that a strike can be averted. A strike is assumed to be averted in this forecast. Instead, as third quarter auto production enters its scheduled period of decline, the industry will contribute less to the economy in the way of production and more in the form of increased consumer durable spending. The incentive program will reinforce this effect, and without an auto strike to intervene, fourth quarter production will expand to restore depleted auto inventories.

Reduced Inflation Projected in Second Half

Inflation, as measured by the consumer price index (CPI), is expected to be more modest in the second half than projected in the previous forecast. The CPI is expected to rise by only 3.9 percent in the second half, bringing the inflation rate to 4.4 percent for 1987 on a fourth quarter over fourth quarter basis. This downward revision for inflation was done mainly to account for the lower inflation rates reported in each month from May through July. These lower rates have been the product of stable food prices and fluctuating oil prices showing little consistent upward potential for the remainder of 1987. In 1988, the CPI is ex-

pected to rise by an almost identical rate of 4.5 percent, on a fourth quarter over fourth-quarter basis.

Long-term Interest Rates Headed for Stable Period

Mortgage interest rates have been averaging well over 10 percent since late spring, and do not show signs of testing the 10 percent barrier in the foreseeable future. For example, conventional commitment rates for thirty-year mortgages with an 80 percent loan-to-value ratio have been hovering around 10.4 percent. We have changed our forecast to reflect this stubborn pattern. The current forecast expects mortgage rates to rise to 10.6 percent in the current quarter before stabilizing at around 10.5 percent for the fourth quarter of 1987 and most of 1988.

While inflationary expectations are certainly a part of this rise in mortgage rates, other factors are involved. Chief among these is the increasing interdependence of financial markets in many different nations. This trend toward globalization not only provides more knowledge of and access to worldwide investment funds, but it makes any one country's economy more susceptible to the economic and political events in another nation. The June trade deficit report is one recent example, but even less international government statistical releases help drive fiancial market opinions which in turn affect the level and direction of interest rates.

REAL ESTATE MARKETS

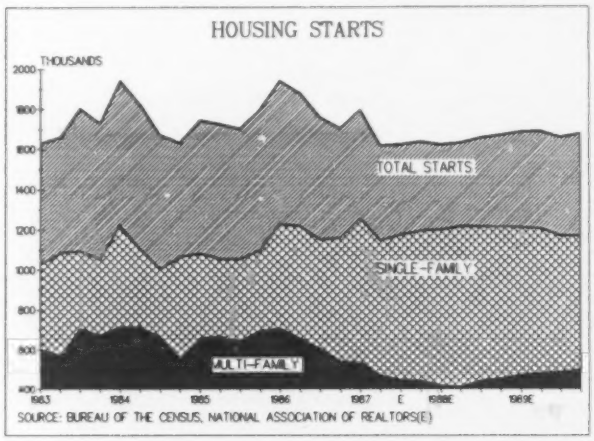
Housing Starts

After four consecutive monthly declines, the annual rate of total housing units started rose in July by 0.9 percent to an annual rate of 1.611 million units, 9.8 percent below July 1986. Since the February 1987 annual rate of 1.838 million units, housing starts had slowly declined to a 1.597 million unit annual rate in June. Whether or not this protracted slide in starts marks the beginning of a housing slowdown is hard to discern due to the interest rate surge.

The weakness in starts extends to both single- and multi- family units. In July, single-family units were started at a seasonally adjusted annual rate of 1.159 million units, up 5.7 percent from the June rate of 1.096 million units. The July rise was the first increase since February 1987, when single-family starts were moving forward at a 1.303 million unit pace.

Multi-family units were started at a seasonally adjusted annual rate of 452 thousand units in July. This was the third time multi-family starts were below the 500 thousand unit level. The July annual rate was 9.8 percent below the 501 thousand unit pace of June 1987, and 27.1 percent behind the July 1986 annual rate.

Total housing starts are expected to reach a seasonally adjusted annual rate of 1.619 million units in the third quarter and 1.635 million units in the fourth quarter. For all of 1987, housing starts could total 1.666 million units. Single-family starts are projected to reach an annual rate of 1.172 million units in the third quarter, and 1.193 million units in the fourth quarter. These quarterly projections would bring single-family starts to a 1987 total of 1.191 million units. Multi-family units are not expected to snap out



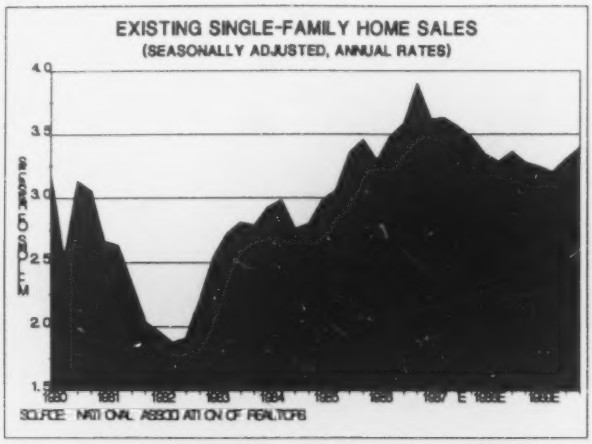
of their prolonged slump for the duration of the forecast horizon. As a result, multi-family units are expected to continue their decline through the rest of 1987, with total starts for the year only reaching 475 thousand units.

Existing Home Sales

Existing single-family home sales are finally showing some measurable reaction to the generally higher levels of interest rates experienced since late March. The July seasonally adjusted annual rate of resales reached 3.53 million units, a 0.9 percent increase from the June annual rate of 3.50 million units. Both of these figures are about 7 percent below the May 1987 annual rate of 3.77 million units, reflecting the interest rate surge. Both the June and July 1987 resale rates are 2.0 percent above their year ago levels, and 1.82 million existing single-family homes were actually sold in the first half of 1987, a 6.3 percent rise over 1986.

These statistics are surprisingly strong, considering the housing industry weathered a 175 basis point rise in mortgage rates during the first eight weeks of the second quarter. The question nobody wants to ask is how long can existing home sales continue at such strong rates? Existing homes are projected to be sold at about a 3.56 million unit annual rate in the third quarter before retreating slightly in the fourth quarter to a 3.48 million unit annual rate. For all of 1987, this works out to be a projected annual total of about 3.57 million units. Resale activity will probably decline slightly to about 3.31 million units in the first half of 1988 in response to the new levels of interest rates. Barring another sudden surge in interest rates, sales of existing single-family homes should post a solid 3.32 million unit rate in 1988.

Paying attention to only the nominal interest rate in 1988 could lead to some overestimations of resale activity. That is why the current forecast carries a special section discussing the factors behind pressures for higher real rates of interest (adjusted for inflation). There is the potential for the relatively high nominal rates of today to move higher as a



consequence of increasing real interest rates. This forecast is particularly sensitive to the forecasted path of inflation and the related issue of real interest rates (see "Risks to the Forecast Section").

New Home Sales

New single-family homes were sold at an annual rate of 653 thousand units in July, a scant 0.5 percent rise from the 650 thousand unit rate of June. More importantly, the July rate is 5.5 percent below the 691 thousand unit annual rate of July 1986, and the June rate was 15.6 percent below the June 1986 rate. The first half of 1987 posted an average annual rate of 700 thousand home sales, 11.6 percent below the 1986 first half annual rate of 792 thousand sales.

Sales of new single-family homes are still reeling from the interest rate surge of the spring. Unlike existing home sales, new home sales reacted after little more than one month following the mortgage rate spike. The higher cost of a new home relative to existing homes caused many potential new home buyers to substitute into existing homes in order to qualify at the higher interest rate levels. But just as an accurate assessment of how much housing starts have fallen due to the interest rate rise is difficult, so too is it difficult to distinguish between a general weakness in new home sales and the interest rate spike.

Prospects Good for Home Prices to Appreciate in Real Terms

The inflation path projected in the current forecast has been revised downward for the second half of 1987. This does not necessarily imply an equal downward revision in real home price appreciation for that period. Should demand for existing homes remain strong as projected in this forecast, home prices should appreciate at about 6.7 percent in 1987, or at a real rate of about 2.0 percent. With a slight slowdown in existing home sales expected in 1988 due to higher interest rates and a weaker economy, home prices could appreciate by 6.1 percent. All but 1.6 percent of this rise would be absorbed by inflation.

New home prices are projected to appreciate as much as 12 percent in 1987, but this is a misleading statistic. A major reason for this rise is the smaller volume of new home sales expected in 1987 because of the interest rate rise. Those new homebuyers remaining in the market are more likely to have higher incomes and can afford a more expensive home. This is expected to bias the home price considerably in 1987, yielding the unusually high growth rate. New home price appreciation is expected to moderate considerably in 1988 to 5.1 percent as builders try to attract lost shares of middle-income buyers by restraining price increases.

RISKS TO THE FORECAST

The Value of the Dollar, Inflation, and Interest Rates

While it may sound as if we are hedging our forecast a bit too much by listing all of these variables as "risks" to the forecast, in truth their interraction is the real source of the risk. The $15 billion trade deficit reported for June dashed hopes of the dollar maintaining its recent gains to near the 150 yen level. The dollar has fallen about 6 percent against the yen following that report. Somewhat ironically, the dollar softening was due partly to beliefs that the Persian Gulf situation will not explode into a major military confrontation that would cutback oil supplies. Central banks around the world have done little to stem the dollar's most recent decline, generally reiterating support for international cooperation to maintain the dollar's value.

Further dollar declines could possibly bring about faster growth in net exports, but at a cost of much higher rates of inflation. The transmission mechanism is twofold. First, import prices will be pushed higher by a lower dollar that cuts into foreign producers' profit margins. Second, domestic manufacturers would gain greater latitude in their own price-setting behavior if their foreign competitors are forced to raise their prices.

But at the same time the falling dollar is helping American manufacturers, it is reducing the value of dollar-denominated assets held by foreign investors. In exchange for holding an asset that could decline in value, foreign investors are demanding and getting higher real interest rates on their investments. These already high real interest rates pose a serious threat to the housing industry. This is not to say that foreign investment is bad for housing, a good case for the opposite can be made. Rather, high real interest rates are a consequence of the persistent trade deficit which has been manifested in large foreign capital inflows. If real interest rates must continue to rise in order to continue to attract the needed foreign capital, then the housing projections made in this forecast could require significant adjustments.

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS				
	Actual		Forecast						Actual		Forecast		
	1987.1	1987.2	1987.3	1987.4	1988.1	1988.2	1988.3	1988.4	1985	1986	1987	1988	1989
AGGREGATE ECONOMY													
Gross National Product (billions of dollars)	4377.7	4447.7	4505.7	4578.1	4646.7	4725.2	4813.0	4891.4	4010.3	4235.0	4477.3	4769.1	5107.1
% Change	8.6	6.6	5.3	6.6	6.1	6.9	7.6	6.7	6.6	4.5	6.8	6.8	7.0
% Change (w/out inflation)	4.4	2.3	2.1	3.1	2.1	3.0	3.1	2.5	3.3	2.2	3.0	2.7	2.7
Consumer Prices (CPI)	5.3	4.9	3.8	3.7	4.3	4.3	5.0	4.6	3.5	1.3	4.4	4.5	4.2
GNP Deflator	4.2	3.8	3.3	3.4	3.9	3.8	4.4	4.1	3.1	2.2	3.7	4.1	4.1
Unemployment Rate (%) (civilian	6.7	6.2	6.0	6.0	6.1	6.1	6.0	6.0	7.2	7.0	6.2	6.0	5.9
Civilian Employment-Household Basis (millions)	111.3	112.2	112.9	113.4	113.7	114.1	114.7	115.1	107.2	109.6	112.4	114.4	116.2
% Change	3.1	3.4	2.8	1.4	1.1	1.8	1.8	1.6	1.9	2.3	2.7	1.5	1.5
Mfg. Capacity Utilization	80.0	80.4	81.2	81.5	81.5	82.0	82.4	82.5	80.3	79.7	80.7	82.1	83.0
Domestic Auto Sales	6.7	7.0	8.3	6.6	7.1	7.4	7.5	7.5	8.2	8.2	7.2	7.4	7.6
Federal Tax Receipts (NIPA) as % of GNP	20.1	20.7	20.0	20.0	20.2	20.3	20.0	20.1	19.7	19.5	20.2	20.1	20.2
Federal Expenditures (NIPA) as % of GNP	24.0	7.1	8.4	6.6	7.1	6.2	5.5	6.1	7.4	10.3	6.6	6.2	5.7
Deficit(NIPA)	-170.5	-141.9	-177.1	-183.6	-172.0	-166.8	-177.3	-178.8	-196.0	-204.7	-168.3	-173.7	-153.3
as a % of GNP	-3.9	-3.2	-3.9	-4.0	-3.7	-3.5	-3.7	-3.7	-4.9	-4.8	-3.8	-3.6	-3.0
REAL ESTATE MARKETS													
HOME SALES													
Total Single-family Home Sales (1000,single-family resales plus 97 percent of single-family starts)	4835	4720	4695	4632	4506	4465	4535	4449	4254	4717	4720	4489	4435
Percent change -- year ago	7.9	1.4	-0.2	-7.6	-6.8	-5.4	-3.4	-4	8.5	10.9	-0.1	-4.9	-1.2
Existing Single-family Home Sales (1000)	3617	3610	3539	3475	3343	3285	3360	3275	3214	3565	3565	3316	3284
Percent change -- year ago	9.9	3.8	-0.8	-10.7	-7.6	-3.9	-5.6	-5.8	12.1	10.9	0	-7	-1
Housing Starts	1794.7	1615.3	1618.8	1635.2	1619.1	1628.7	1652.9	1666.7	1742.3	1819.2	1666	1641.8	1676
Percent change -- year ago	-7.4	-14	-7.9	-3.9	-9.8	0.8	2.1	1.9	10.2	-5.3	-3.9	1.9	0.3
Single-Family Units	1255.7	1144.7	1171.6	1193	1198.9	1216.3	1211.7	1210.7	1072.6	1188.1	1191.2	1209.4	1187
Percent change -- year ago	2.4	-5.9	1.9	3	-4.5	6.3	3.4	1.5	2.9	5.6	3	1.5	-3.6
Multi-Family Units	539	470.7	447.1	442.2	420.1	412.5	441.2	456	669.7	631.2	474.8	432.4	489.1
2-4 Family Units	80	73.7	70	69.2	65.7	64.6	69	71.4	93.4	85.4	73.2	67.7	76.5
Percent change -- year ago	-16.7	-9.1	-8.7	-21.4	-17.8	-12.4	-1.3	3.1	-29	7.8	-21.4	3.1	10.8
5+ Family Units	459	397	377.2	373	354.4	347.9	372.1	384.6	576.2	545.8	401.5	364.8	412.5
Percent change -- year ago	-25.4	-31.6	-29.1	-18.1	-22.8	-12.4	-1.3	3.1	37.4	-26.3	-18.1	3.1	10.8
New Single-family Home Sales (1000)	724	675	665	675	684	689	675	701	688	749	685	687	700
Percent change -- year ago	-8.2	-14.9	-3.1	-5.1	-5.5	2.1	1.5	3.9	7.7	8.9	-8.5	0.3	1.9
Mobile Homes Shipped (1000)	233.7	226.7	253.2	258.2	261.2	265.4	266.9	268.8	282.9	248.9	242.9	265.6	314.1
HOME PRICES													
Existing Home Prices - Median ($1000)	84.2	85.1	86.5	85.8	89.3	91.2	91.5	90.5	75.5	80.3	85.4	90.6	95.4
Percent change -- year ago	7.6	3.8	7.2	7	6.1	7.2	5.8	5.4	4.4	6.4	6.4	6.1	5.3
New Home Prices - Median ($1000)	97.4	103.2	106.1	105.3	108	109	108.4	107.9	84.3	92	103	108.3	113.6
Percent change -- year ago	10.3	12.3	13.5	10.8	10.9	5.6	2.2	2.5	5.5	9.1	12	5.1	4.9
FINANCIAL MARKETS													
Long-Term Interest Rates (%)													
30-year Fixed Rate Mortgage (FHA Secondary)	8.8	10.3	10.6	10.5	10.5	10.5	10.4	10.4	12.2	9.9	10.1	10.5	10.2
1-year ARM (without buydown)	8.3	8.1	8.1	8.3	8.3	8.4	8.3	8.1	7.6	7.9	8.2	8.3	8.1
Corporate AAA Bond Rate	8.4	9.2	9.5	9.4	9.4	9.4	9.4	9.3	11.4	9	9.1	9.4	9.1
Government Bond Rate	7.5	8.5	8.8	8.7	8.7	8.7	8.7	8.7	10.8	7.8	8.4	8.7	8.4
Federal Funds Rate	6.2	6.7	6.7	6.8	6.9	7	7.1	7.1	8.1	6.8	6.6	7	7
3-month T-Bill Rate	5.5	5.6	5.9	6.1	6.2	6.3	6.5	6.4	7.5	6	5.8	6.3	6.4
Prime Rate	7.5	8	8.3	8.3	8.5	8.7	8.8	8.8	9.9	8.3	8	8.7	8.8
Discount Rate	5.5	5.5	5.5	5.5	5.7	5.9	6	6	7.7	6.3	5.5	5.9	6
Money Supply (M1)(% change)	13.8	6.5	1.6	4.2	5.4	6.2	8.1	7.3	11.9	15.2	6.4	6.8	7.6
Value of the U.S. Dollar (Trade-Weighted Avg.)	99.9	97	98.5	97.8	97.5	96.9	96.9	96.7	143.2	112.3	98.3	97	95.9
Percent Change	-24.2	-11.1	6.5	-2.8	-1.3	-2.3	0	-0.8	-12.9	-16.5	-8.6	-1.1	-1.1

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr. Frederick Flick and Sean Burns.

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